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IMPACT OF CHANGES IN THE TELECOMMUNICATIONS INDUSTRY ON SMALL BUSINESS

(Part 2)

HEARINGS

BEFORE THE

SPECIAL TASK FORCE ON THE IMPACT OF TELEPHONE COSTS

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

SECOND SESSION

SEATTLE, WA, AUGUST 23, 1984, AND KANSAS CITY, MO, AUGUST 24, 1984

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IMPACT OF CHANGES IN THE TELECOMMUNICATIONS INDUSTRY ON SMALL BUSINESS

(Part 2)

THURSDAY, AUGUST 23, 1984

House of Representatives,
Special Task Force on the Impact of Telephone Costs,
Committee on Small Business,
Seattle, WA.

The task force met, pursuant to notice, at 9:05 a.m., in the South Auditorium, Jackson Federal Building, 915 Second Avenue, Seattle, WA, Hon. Ron Wyden (chairman of the task force) presiding.

OPENING STATEMENT OF CHAIRMAN WYDEN

Mr. Wyden. Good morning. Today the House Small Business Committee task force on telephone rates has come to Seattle to hear the concerns of residents in the Pacific Northwest about telephone rates and services.

The committee has already held one hearing in Washington. Tomorrow we meet with residents of the Midwest in Kansas City. We expect other hearings further along in the summer and fall, and then we expect as members of the task force to furnish recommendations to the House Small Business Committee on November 30 about how best to hold down business telephone costs.

I believe that telephone rates and communications are the consumer pocketbook issue of the 1980's whether the ratepayer is at home or at the office. The communications world has undergone a radical transformation in recent days and not all the implications of this transformation are good ones.

Just a few days ago, I was at a dedication in my congressional district. I think all of you in the audience are familiar with congressional dedications. You are almost always at these things, seeing a Member of Congress cutting a ribbon or bow to announce the opening of a dam, a highway or bridge or piece of our industrial base.

This dedication is a little different. We were dedicating a community phone, and it was a phone being run by a church in my district for citizens who could no longer afford telephone service. The people of this church had gotten a small grant from a charitable organization and staffed the community phone with members of the church and very concerned residents in the community, and they were going to run it essentially on a 40-, 50-hour-a-week basis, just to take messages from doctors and relatives and emergency kinds of situations for those who could no longer afford a phone.

I remember just a couple of days ago saying I would have ambivalent feelings about all this. It was great that the community was doing it, and I felt at the same time a little sad that it was necessary. I think all of you in the audience and us on the task force don't want to see the need for a tremendous number of community phones, we don't want to see an information aristocracy in this country where those who are well to do have access to fiber optics and robotics and all kinds of sophisticated communication devices, and then our business and residential ratepayers can't even afford basic service.

We are looking at ways to keep phone rates affordable, and there are two prime vehicles that we need to look at. One, we know that the Congress early next year will return to the Communications Act. It has not been rewritten since 1934, and here we sit in the 1980's, so it is clear next year we are going to have to make some changes in the Communications Act of 1934 to keep it up with the times. When we do that, the State legislatures are going to be in a position of having to respond.

So we also want to hear today about how the States should respond to the Communications Act, because of the various changes going on in telecommunications. I think today we have a very good opportunity to try to think through the alternatives, try to think through the options, look at ways to insure that we keep our commitment to universal telephone service.

I am pleased to have two of my distinguished colleagues with me today, Congressman Swift, a good friend, and I am not supposed to call him my mentor anymore, because I think he suspects that that makes him feel old——

Mr. **Skelton**. He is old. [Laughter.]

Mr. **Wyden** [continuing]. But nobody has been more helpful to me in the Congress, and I think it is fair to say that there really isn't anybody in the Congress who knows more about communications issues than Congressman Swift. He will have some remarks by way of an opening statement.

And then our good friend and distinguished colleague, Congressman Skelton, will have remarks.

With that, Al, please, whatever you want to open with.

TESTIMONY OF HON. AL SWIFT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WASHINGTON

Mr. **Swift**. Thank you very much.

I appreciate your letting me sit in with this Committee on Small Business of which I am not a member. You and I serve on the Energy and Commerce Committee and have worked on telephone legislation there for some time. In fact, when I introduced the telephone bill as a prime sponsor, you were the cosponsor. I say the cosponsor—there was only one, Ron Wyden, from Oregon. That was a bill which had total exemption for small business from the access charge.

As it went through the legislative process, we didn't have enough support at that time to be able to hold that total exemption. It got whittled down to a single first line, and that is, it is interesting in the point that I would like to make. This is a highly complex issue. It is a very technologically oriented issue and it is difficult to understand. It is an issue which we found has been hard to get people to focus on.

That is the reason I think these hearings are so important. Had the small business community really understood more clearly what was at stake at the time we were running legislation to reverse the access charge decision of the FCC, I think we would have passed it. We got it through the House. It failed by very few votes to be passed by the Senate.

Now, I think small business is more keenly aware of what is at stake with the approach that the FCC has taken. It has proposed that access charges make up the revenue lost to local telephone companies when the subsidy from long-distance ceased to exist. It is not a simple issue.

What was at stake in my judgment ultimately is the concept of universal services as we have always defined it, and that goes to the individual telephone user as well as to the small business user. The small business user does not have the same resources that large business has to deal with these access charges.

As a result, those access charges become an unavoidable increased cost to the small business user whereas to his larger business competitor, it does not necessarily mean increased cost because the larger business consumer has greater options.

So, Ron, I am delighted to welcome you here to Washington State. You have welcomed me a number of times at Portland. I appreciate the opportunity to return the favor. I commend you for holding these hearings because I can't think of an issue affecting small business that needs more information laid out on the table so people can wisely make up their minds.

Mr. **Wyden**. Thank you very much for an excellent statement. We do very much appreciate being here in Washington and being with you.

I think we are also very fortunate to have Congressman Skelton who is so concerned about this issue that he will travel great distances and break from his own very busy schedule to be with us. Ike, on behalf of the task force, we very much appreciate your coming.

Mr. **Skelton**. Thank you very much, Ron.

I would like to first thank the good folks of Seattle for their courtesy that they have extended to me. However, I have only been here a short time. Someone asked me this morning, "Isn't this a beautiful city?" My answer was, "I don't know, I got in so late last night and immediately after breakfast I came here," so I hope between here and the airport I can answer that question with a resounding yes.

Al Swift is not only one of the most respected Members of Congress but one of the most popular, and I am pleased to be in the same hearing with my good friend, Al Swift. He is, as Congressman Wyden pointed out, very, very learned in the area of communications, and I appreciate his interest to this particular subject, and we appreciate him coming to ask questions and to learn.

Congressman Ron Wyden, our chairman, I would be remiss if I didn't say something about him. I jokingly said that Al Swift was old a while ago. In all honesty, I am probably the oldest of the three, the youngest of the three is our friend, Chairman Wyden, on this task force. But he has made a very outstanding name for himself already in the Congress.

We recently passed a bill that deals with computer fraud crime, and it is his brainchild, and there was a very nice article praising his work in the National Journal just a couple weeks ago, and if he gives the same leadership, which I already see coming to this issue, as he gave to the computer fraud issue, I think that we will have some positive results from this.

This is a hearing where we are trying to learn. I am from Missouri. Our famous quotation from Missouri is "show me." I am here to be shown and to learn about this very complex issue. As was mentioned, this is a very difficult-to-understand issue, very complex. It is kind of like a jigsaw puzzle, when you put a piece in, three pieces pop out. Nothing seems to fit, and yet the FCC came forth with a ruling not long ago that seemed to single out multi-line telephone users in the area of small business.

We are here doing the job that the FCC should have done before it issued its order that singled out multi-line phone users in the small business area. We are here to do the homework that they should have done, and we will discuss the access charges and also discuss local measured service which is important to you here and which recently surfaced in my home State of Missouri.

I do appreciate this opportunity to be with you, and I look forward to our panelists who will be with us. I hope you will understand that we are on a time schedule, and as the chairman, I know, will push you along, we have to meet our time schedule so we can get an airplane this afternoon.

Thank you very much for your courtesy. We look forward to hearing from the witnesses.

Mr. WYDEN. Thank you for coming such a long way.

Our first panel is Mr. Gary Smith, the executive director of the Independent Business Association of Bellevue; Mr. Jim Bernau, director of government relations of the Oregon National Federation of Independent Business; Mr. Mark Dodson, of TRACER, Portland; Garett Terry, Association for Retarded Citizens, Portland; Ms. Whitney McCleary, member of the board, Public Interest Research Group, Seattle; and Mr. Gordon Lindstrom, United Services, Inc., Seattle, WA.

Why don't we begin with Mr. Gary Smith. Welcome. I think because of the fact we have so many witnesses, we will make a formal copy of your statement a part of our record, and if each of you could just summarize your views and highlight those things that are most important to you and your organization, I think we may be able to finish before dinner time or the weekend.

Mr. Smith, please proceed.

TESTIMONY OF GARY L. SMITH, EXECUTIVE DIRECTOR, INDEPENDENT BUSINESS ASSOCIATION

Mr. SMITH. Thank you, Mr. Chairman.

I am Gary Smith, executive director of the Independent Business Association.

To help identify that for you, we are an association of small businesses throughout the State of Washington. We have approximately 4,000 small businesses throughout the State of Washington, and we define a small business as having 20 or fewer employees, which represents about 85 percent of all businesses in the State of Washington.

We sincerely appreciate your efforts to come here to the city of Seattle and to seek our input on the telephone issue as it affects small business. This is one of the biggest concerns of small business in the State of Washington. We are having a lot of people calling our office, saying "What is happening?" And I would like to give you a basic perspective, as we understand it, from small businesses.

They are very confused. They don't know what is happening, and they are not exactly sure what is going to happen in the future. They don't understand the terms like LATA and access charge. Many of them are outraged, but they don't know what to do, which government entities to talk to, or how to talk to them. Others have given up and say it is inevitable—we can't do anything about it, so we will just sit here and take it, I guess.

The impact on small business is significant. They are seeing significant increases in their costs and, from their perspective, no increase in service. They are seeing increases in common costs, increases from new charges, like common equipment charges, increased costs for their basic service, and again they don't understand why. They are seeing greater costs for small businesses relative to larger businesses.

Key systems used by most small businesses have had equipment cost increases significantly higher than that of other types of equipment. They have seen a new charge called the common equipment charge, $11.20 per month for the first four lines, so that is a cost of up to $11.20 for a single phone line, or as low as $2.80 per line for your first four lines.

However, if you are a bigger firm, it is then $1.40 for each line after that. Obviously, the costs on the front end are higher, and most small businesses don't have many more than four lines.

One of the major concerns is the issue of access charges. Again, most small businesses don't understand it. We understand the basic purpose behind an access charge was to put in place a system to avoid bypass of the public network, a system, that we would keep as many customers as possible on the public network and transfer costs for the local loop back to the local telephone customer.

Now, as we all know, there has been a major Federal policy change. This Federal policy change has direct impacts on small businesses and, quite honestly, could make a major risk to the overall cost of small business telephone service because of this change. There are basically two scenarios. The first is the current access charge formula where the Federal Government has said we will eliminate the access charge for residential customers, we will eliminate the access charge for single-line businesses and we will continue the consumer access line charge for businesses with two or more phone lines at $6 per month.

What is essentially happening is long-distance rates have not been decreased to the degree that they were anticipated to be decreased because they have to be higher in order to make up the costs that are not being paid by consumer access line charges on residential and single-line businesses. So the result is under this scenario that we may, in fact, see, is bypass because this system is not reducing the cost to the degree that makes it cost effective for larger firms that can afford bypass, not to bypass.

The end scenario of this scenario is if we have businesses bypassing the public network, it results in a significant amount of plant and equipment no longer being used by those companies, which ends up increasing the cost to those who can't afford to bypass to get out of the public network; namely, small business, so their costs go up.

The other scenario is that we have those businesses with two or more telephone lines to pick up charges that are not being paid by single-line businesses and residences. The fear here is that small businesses are looking for a significant increase in their overall basic telephone costs—we estimated between $960 to $1,200 a year—because of the access charges not being put on single-line businesses, the bottom line being their costs go up and they are subsidizing those other types of customers.

We believe very strongly that access charges must be made equal for all telephone customers. Most residents are in a position to pay their portion of the consumer access line charge, the single-line businesses are in a position to pay their portion, so the small businesses, years down the road, are not caught in a very difficult and costly situation as a result from either of the scenarios.

I know this might be contrary to some people's thinking, but I think it is something that we have to face in a very real situation because small businesses with two or more lines right now are going to face very significant problems in the future, unless something is done.

Finishing on the issue of access charges, we would encourage the Congress to encourage the FCC very strongly to look at the costs used by the Telcos in basing their access charge needs. We have gone through the intrastate access charge here in the State of Washington, and as our written comments indicate, there were some costs used as a basis to calculate the intrastate consumer access line charges which we had strong questions about. Are they a real cost, or are they not?

We have three other issues that we have included in our written comments. One is dealing with mandatory local measured service. As the committee may well know, this was proposed in the State of Washington in late 1983. It was suspended. In the legislative session in 1984, our organization found that this issue was something that was not part of the divestiture issue, No. 1; No. 2, it was a major policy change; and No. 3, we didn't need to rush into it because the telephone company said that there was no increase in revenue to them, it was just a different way of collecting their revenues.

At that point, we introduced legislation into the legislature, putting a prohibition until June 1985, so there could be a study and determine the impacts of mandatory measured service on businesses. To be frank, we have a lot of small businesses that are very concerned. It is a high priority issue that mandatory measured service be prohibited in the State of Washington.

The reason is that small businesses are very dependent on their telephones. They are not in a position, as larger firms are, to use the mass media in order to communicate with their customers. They can't afford it. Therefore, they do more one-on-one communication, and the telephone is a necessary tool to do that.

The next issue is detariffing. The telephone companies requested legislation that if there is competition for a service they provide that they, in fact, have the opportunity to charge whatever rate they felt was appropriate that was above their cost. This proposal, of course, would not have them go through our public utilities commission in order to determine if that rate was fair or not.

Small businesses felt their costs were based on plant and equipment installed some years back and at lower interest rates, so somebody entering the marketplace with a limited amount of equipment at today's prices paying today's interest rates maybe couldn't compete on a cost basis.

The final issue is affiliated interest where the telephone companies proposed to be able to purchase goods and services from related companies under the umbrella, if you will, from the holding company of Pacific Northwest Bell, U.S. West, so they might buy data services or real estate or something like this through U.S. West, which is, in fact, the parent company.

The proposal allowed that if they could establish what a fair competitive price was in the open marketplace, that would be the cost they could use for that service purchased from a sister company and use that in the calculation of rates for their overall rate structure.

We had a major concern with that because in most situations, they would not have a marketing cost and the competition price would already include a profit. Pacific Northwest Bell is already under the utility laws which includes in their rates a provision for a return on investment. It appeared to us that they would have a significant increase in their income to their sister companies without some of the expenses a competitive company might have.

We are very concerned with that proposal. We feel that there are a number of questions that need to be answered before that proposal should be adopted into law. We think it is something that the Congress should look at if something like this is considered on the national level.

Thank you for your time. I would be happy to respond to questions.

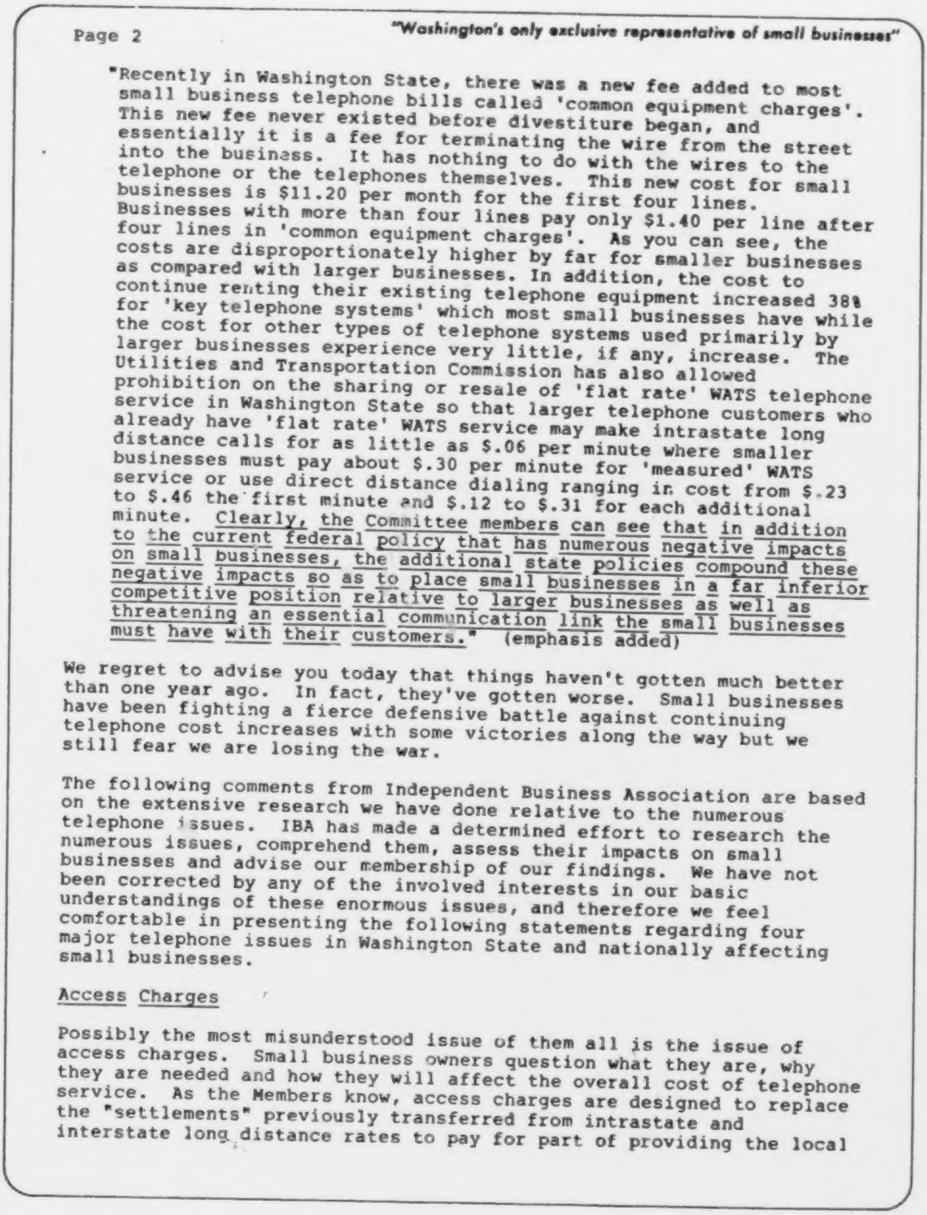
[Mr. Smith's prepared statement with attachments follows:]

PREPARED STATEMENT OF GARY L. SMITH, EXECUTIVE DIRECTOR, INDEPENDENT BUSINESS ASSOCIATION

Thank you for this opportunity to appear before you and present the views of Washington small business owners regarding issues involving telephones. We sincerely appreciate your efforts to hold this hearing in Seattle to allow those of us on the west coast who find it extremely difficult to travel to Washington D.C. to present our ideas. We also wish to commend your staff for the outstanding job they have done in arranging this meeting and especially the work done by Mr. Kent Hall.

Today we will present comments on four specific telephone related issues. However, we wish to first provide the Task Force Members a broader perspective by the small business community relative to the telephone issues. The Members must understand that the average small business owner is totally frustrated about the entire telephone issue. Here in Washington State, small business owners have seen significant increases in their telephone costs with no additional services added. Most small business owners don't know why their telephone costs are increasing but they are very upset about it. The average small business owner does not understand what a LATA is, what Access Charges are, or which government authorities are responsible for what's happening. Some small business owners have simply given up and accepted the increased costs as inevitable and feel that nothing can be done to stop the increases. Others are outraged, but don't understand what's happening or what they can do about it. Clearly, small business owners are suffering the largest cost increases, but due to the many demands on their time to keep their businesses operating profitably, they are unable to fight back.

Almost one year ago, on August 29, 1983, we testified before the U.S. Senate Committee on Commerce, Science and Technology on the telephone issue. The following is just a portion of that testimony to indicate the cost increases small businesses have been experiencing:



> "Recently in Washington State, there was a new fee added to most small business telephone bills called 'common equipment charges'. This new fee never existed before divestiture began, and essentially it is a fee for terminating the wire from the street into the business. It has nothing to do with the wires to the telephone or the telephones themselves. This new cost for small businesses is $11.20 per month for the first four lines. Businesses with more than four lines pay only $1.40 per line after four lines in 'common equipment charges'. As you can see, the costs are disproportionately higher by far for smaller businesses as compared with larger businesses. In addition, the cost to continue renting their existing telephone equipment increased 38% for 'key telephone systems' which most small businesses have while the cost for other types of telephone systems used primarily by larger businesses experience very little, if any, increase. The Utilities and Transportation Commission has also allowed prohibition on the sharing or resale of 'flat rate' WATS telephone service in Washington State so that larger telephone customers who already have 'flat rate' WATS service may make intrastate long distance calls for as little as $.06 per minute where smaller businesses must pay about $.30 per minute for 'measured' WATS service or use direct distance dialing ranging in cost from $.23 to $.46 the first minute and $.12 to $.31 for each additional minute. Clearly, the Committee members can see that in addition to the current federal policy that has numerous negative impacts on small businesses, the additional state policies compound these negative impacts so as to place small businesses in a far inferior competitive position relative to larger businesses as well as threatening an essential communication link the small businesses must have with their customers." (emphasis added)

We regret to advise you today that things haven't gotten much better than one year ago. In fact, they've gotten worse. Small businesses have been fighting a fierce defensive battle against continuing telephone cost increases with some victories along the way but we still fear we are losing the war.

The following comments from Independent Business Association are based on the extensive research we have done relative to the numerous telephone issues. IBA has made a determined effort to research the numerous issues, comprehend them, assess their impacts on small businesses and advise our membership of our findings. We have not been corrected by any of the involved interests in our basic understandings of these enormous issues, and therefore we feel comfortable in presenting the following statements regarding four major telephone issues in Washington State and nationally affecting small businesses.

Access Charges

Possibly the most misunderstood issue of them all is the issue of access charges. Small business owners question what they are, why they are needed and how they will affect the overall cost of telephone service. As the Members know, access charges are designed to replace the "settlements" previously transferred from intrastate and interstate long distance rates to pay for part of providing the local telephone service to the customer. There are two types of access charges: the Consumer Access Line Charge (CALC) and the Carrier to Carrier Access Charge (CCAC). The original philosophy of the CALC was to increase the cost to each telephone customer so that the customer paid the full cost of providing local telephone service and at the same time reduce the CCAC so that long distance telephone rates would decline and the incentive by larger firms to by pass the public telephone system would be reduced.

As we indicated, this was the original philosophy. Clearly, on the federal level, this philosophy has been significantly changed by eliminating the CALC for some types of customers. This change on the federal level adds disproportionately higher costs to smaller businesses and threatens to significantly increase the costs for small businesses in the future.

The original federal policy was to charge residential customers a $2 per month interstate CALC and charge business customers a $6 per month interstate CALC. Due to political pressures, the FCC abandoned the $2 per month residential interstate CALC and the $6 per month business interstate CALC on businesses with only one telephone line. Businesses with 2 or more telephone lines pay a $6 interstate CALC per line per month. The result is, small businesses with 2 or more telephone lines are paying a minimum of $12 per month in additional telephone costs. However, because the residential customers and the single line business customers are not paying any interstate CALC, the CCAC had to set at a higher level than was originally intended resulting in higher than anticipated long distance rates. So instead of small businesses with 2 or more telephone lines being able to offset the $12+ per month interstate CALC by reduced long distance rates, the long distance rates have not been reduced as much as intended meaning these businesses are paying more for their telephone service.

The long range impacts of the revised federal policy are of even more concern. If residential and single line business customers are exempted from paying any interstate CALC, small businesses with 2 or more telephones face major cost increases in the future in one of the following ways:

1. The interstate CALC for small businesses with 2 or more lines will have to be increased, possibly by as much as $3 to $4 per month, to offset the interstate CALC revenues that would have been paid by the residential and single line business customers. In 5 years, the interstate CALC for a business with 2 or more lines could be $45 to $50 per month per line, or a minimum of $960 to $1200 per year for just two phone lines in addition to their basic monthly service costs for local telephone service. The interstate CALC would then represent about a 170% increase in their basic telephone costs.
2. If the CALC for businesses with 2 or more lines is not increased and the exemption for residential and single line businesses continues, the result will be higher than necessary long distance rates. Such inflated rates will then encourage the larger businesses which can afford to by pass, to do so. This will

result in residential customers and small businesses who cannot afford to by pass the public system having to pay higher telephone rates to pay for the unused equipment of the telephone company formerly used to provide service to the large customers that decided to bypass the public network.

Changes must be made! IBA seriously believes the federal government should reconsider its policy regarding CALC charges for residential customers and single line business customers. Single line business customers should be required to pay the CALC, the same as all other business customers to avoid providing a competitive advantage to one telephone customer over another telephone customer. Most residential customers should be made to pay the original $2 CALC proposed. For those residential customers who are indigent, the establishment of a Universal Service Fund should be done to subsidize those customers.

One additional thought on access charges. The State of Washington has addressed the intrastate access charge issue. This has resulted in a $32 million revenue increase to the state's telephone companies. Pacific Northwest Bell will receive about $26 million of the total increase. IBA expressed concerns to the state's Utilities and Transportation Commission regarding the justification for the requested increases. The Commission approved the increase request. However, IBA questioned the justification of costs used as the basis for this increase such as the following examples:

Attrition Adjustment for loss of MTS revenue	$12.2 Million
Costs to manage stockholder matters	2.0 Million

We strongly urge the Members to have Congress reemphasize that the FCC carefully review revenue requests of telco's in determining the interstate portion of the access charges. Each cost should be totally justifiable or otherwise rejected as a cost used to base access charges.

Mandatory Measured Local Business Telephone Service

On November 23, 1983, Pacific Northwest Bell requested authorization to charge all business customers on the basis of time and distance for each local telephone call. The original order was suspended. Early in the 1984 legislative session, Independent Business Association proposed and successfully passed legislation prohibiting initiation of Mandatory Measured Local Business Telephone Service until June 1, 1985 (See attachment a). This legislation also required the Utilities and Transportation Commission to conduct a study on the economic impacts of Mandatory Measured Local Business Telephone Service. This study is due to be completed by November 1, 1984.

Small business owners have expressed a great deal of concern to IBA regarding the proposal of Mandatory Measured Local Business Telephone Service. Pacific Northwest Bell testified that Mandatory Measured Local Business Telephone Service would not generate any new revenues for the telephone company. In addition, Mandatory Measured Local Business Telephone Service is unrelated to divestiture. Due to the confusion of divestiture related issues, IBA found no reason to compound the divestiture issues with another unrelated, major policy change.

Based on the proposal by Pacific Northwest Bell, IBA calculated the break even point for Mandatory Measured Local Business Telephone Service as follows:

12 3-minute calls per day per line during business hours
7 6-minute calls per day per line during business hours

Based on this information, IBA received overwhelming opposition from its small business members on this Mandatory Measured Local Business Telephone Service proposal.

IBA has several major concerns as to the justification of Mandatory Measured Local Business Telephone Service as follows:

1. How do the prices proposed relate to the incremental costs to provide local telephone service?
2. There is no customer request for Mandatory Measured Local Business Telephone Service. Why then is it being requested if there is no revenue increase?
3. Won't tapered discounts for high volume users encourage greater use of the system by high volume users at the expense of the low volume user?
4. Will Mandatory Measured Local Business Telephone Service increase the basic service cost in the future because of a reduction in the volume of telephone calls on equipment which is being amortized based on use?
5. How much will Mandatory Measured Local Business Telephone Service encourage local by pass and therefore increase the costs to those small customers who cannot afford to by pass the local public network?
6. How much will Mandatory Measured Local Business Telephone Service affect the ability for small businesses to compete in the marketplace? Small businesses cannot afford the large media advertising that larger businesses utilize. Therefore, small businesses are far more dependent on utilizing one-on-one contacts through personal sales and telephone contacts in order to compete effectively.
7. What other pricing alternatives, such as special tariffs for data processing transmission or more distance bands, have been considered?

We believe that very careful analysis of the entire Mandatory Measured Local Business Telephone Service proposal is essential. Small businesses are totally dependent on the local public network and many could experience very sizable cost increases as a result of this proposal. We believe the study to be completed by November, 1984 will help answer many of these questions. However, the primary question still remains, "If there is no revenue increase to the telephone company and there is no customer demand for this major policy change, why is it being proposed?"

Detariffing of Rates

During the 1984 Washington State legislative session, the telephone companies proposed legislation commonly referred to as "Detariffing". (See attachment 2, Sections 2, 3, 4, & 6) This legislation would allow telephone companies to set their rates without review by the Utilities and Transportation Commission for services they offer and for which competitive services are available. This is a major change from current policy. The telephone companies are requesting this legislation to allow them more flexibility to be able to compete in the new competitive telephone market.

Independent Business Association is sympathetic with the concern of the telephone companies to be able to react rapidly to effectively compete with competitors. However, this proposed legislation appears to allow the telephone companies to engage in "predatory pricing" to drive competitors out of the marketplace.

In section 2 of the legislation on page 2, lines 28 through 30, the Members will see that this legislation would allow the telephone companies to charge any price which is "...not lower than the cost of providing such service...". Clearly, the established telephone companies have a definite "cost" advantage over new firms entering the marketplace. Most of the telephone equipment and associated facilities of the established companies were installed in prior years when costs were lower than they are now and when interest rates were lower. Therefore, the telephone company's cost would generally be below that of a company beginning operations now. If the telephone company is allowed to charge the "cost" for a competitive service, it is anticipated that they would be able to undercut any potential competitor's price and therefore discourage any competition from entering the market or drive competition out of the marketplace.

If a telephone company's pricing drives competitors out of the marketplace, the telephone company can then re-tariff their service and enjoy the protections of the Utilities and Transportation Commission to set the rates for their service to provide for the allowable rate of return.

While we believe in the concept of competition, we believe that many safeguards are necessary in this legislation to assure the encouragement of competition, not the discouragement of competition as we feel this particular proposal provides. Such safeguards could include:

1. What is competition? If a competitor has only the capacity to service 5% of the total potential market, is this real competition? A clear definition of competition must be spelled out.
2. How big is the geographical area of competition. If a telco's competitor can only service 10% of the telco's service area, should detariffing be allowed in the entire area? Again, a

clear definition of competition is vital.

3. What is "cost"? Does this cost include all associated overhead expenses such as billing, administration, marketing, etc? A very clear definition of cost is necessary in this proposal.

4. If a telco is detariffed and then retariffed, we strongly believe that the maximum tariff for the formerly detariffed service would be the lesser of the lowest price for the service by the telco during the detariffed period plus the contribution for the allowable rate of return, or a tariff based on conventional cost base tariff setting. This would reduce but not eliminate the potential for "predatory pricing".

Affiliated Interests

During the 1984 Washington State legislative session, the telephone companies proposed legislation commonly referred to as "Affiliated Interests" (see attachment 2, section 5). A summary of this legislation is to allow the telephone companies to purchase goods and services from "affiliated" companies and use the "fair competitive price" as the cost on which their telephone rates are calculated for the goods or services supplied by the affiliate company. There is a major policy change in this proposal that concerns many small businesses. Currently, goods and services supplied by related companies to a telephone company are calculated based on their cost for the purposes of calculating telephone rates. Allowing the telephone company to use the "fair competitive price" instead of the "cost" could have substantial impacts on telephone rates.

Attachments 3,4 and 5 better illustrate the concept of "affiliated interests". Attachment 3 shows the concept of "affiliated" companies in the case of Pacific Northwest Bell. Examples 3 shows that PNB, a fully owned subsidiary of U.S. West is just one of a number of companies owned by U.S. West. Only Pacific Northwest Bell in this example is a regulated utility company. All of the other other companies are not subject to any utility regulation. All of these companies are "affiliated" due to common ownership through U.S. West.

Attachment 4 indicates the difference between the "cost" based concept and "competitive market price" concept proposed and its impacts on telephone rates. The figures shown under "Now" are the current cost base concept. The figures under "SB 4519" are the anticipated results of this example if "affiliated interests" legislation allowed the "fair competition price" concept to apply. As the Members can see, there is an increase of $9.99 or 36% in the case of this example.

Attachment 5 indicates the total impact to rates based on the percentage of total goods and services purchased from "affiliated" companies using the same ratios as were used for the example.

Small businesses have a major concern over what is the competitive price of a service or goods from an "affiliated" company. This proposal allows the telephone company to use a competitive price as a non-rebuttable price for the purposes of rate calculations. Can the telephone company take the highest market price as the "fair competitive price"? Is one competitive price enough to establish a "fair competitive price"? Does an estimated competitive price from a firm not currently providing the subject service or goods qualify as a "fair competitive price?"

Should the telephone company be allowed a "rate of return" based on the "fair competitive price" which generally would already include a markup for marketing and profit.

Until major safeguards are included in this proposal, IBA, on behalf of small businesses, will be opposing this legislation because of its potential cost and potential for conflict of interest.

Conclusion

On behalf of thousands of Washington small business owners, Independent Business Association again thanks the Members for their interest in our comments and we trust the information we have presented will be helpful to the Task Force. If IBA can be of any assistance, please feel free to call on us.

Sincerely,

Gary L. Smith
Executive Director

ENGROSSED SUBSTITUTE HOUSE BILL NO. 1825

State of Washington 48th Legislature 1984 Regular Session

by Committee on Energy & Utilities (originally sponsored by Representatives Jacobsen, Nealey, Barrett, Lewis, Belcher, Ballard, Haugen, Ellis, Lux, Dellwo, Burns, Crane, Fisher, Braddock, Moon, Fisch, Nelson, Scott, Zellinsky, Stratton, Garrett, Galloway, J. King, Todd, Ebersole, Wilson, McClure, Sommers, Vekich, Appelwick, Sayan, Wang, Isaacson, Charnley, Allen, McMullen, Powers and Kaiser)

Read first time February 4, 1984.

AN ACT Relating to mandatory measured telephone service rates; amending section 80.04.130, chapter 14, Laws of 1961 and RCW 80.04.130; creating a new section; and declaring an emergency.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. Sec. 1. The Washington utilities and transportation commission shall conduct a comprehensive study to include, but not be limited to, the social and economic impact upon the residential, business, governmental, and nonprofit telephone customers by implementation of mandatory local measured telephone service rates.

The commission shall seek the cooperation of the joint select committee on telecommunications as well as representatives of the telephone industry, business interests, consumer groups, senior citizen groups, community service groups, nonprofit organizations, social service agencies, and all other interested parties in conducting the study.

The commission shall report to the appropriate committees of the house of representatives and the senate no later than November 1, 1984, with the findings of the study and recommendations regarding the implementation of mandatory local measured telephone service.

Sec. 2. Section 80.04.130, chapter 14, Laws of 1961 and RCW 80.04.130 are each amended to read as follows:

(1) Except as provided in subsection (3) of this section, whenever any public service company shall file with the commission any schedule, classification, rule or regulation, the effect of which is to change any rate, charge, rental or toll theretofore charged, the commission shall have power, either upon its own motion or upon complaint, upon notice, to enter upon a hearing concerning such

proposed change and the reasonableness and justness thereof, and pending such hearing and the decision thereon the commission may suspend the operation of such rate, charge, rental or toll for a period not exceeding ten months from the time the same would otherwise go into effect, and after a full hearing the commission may make such order in reference thereto as would be provided in a hearing initiated after the same had become effective.

(2) At any hearing involving any change in any schedule, classification, rule or regulation the effect of which is to increase any rate, charge, rental or toll theretofore charged, the burden of proof to show that such increase is just and reasonable shall be upon the public service company.

(3) The implementation of mandatory local measured telephone service is a major policy change in available telephone service. The commission shall not approve, prior to June 1, 1985, any filings which are under suspension as of the effective date of this 1984 act, which are awaiting an order by the commission, or which are filed on or after the effective date of this 1984 act if the filing involuntarily requires any telephone user to pay for all outgoing local telephone calls based on time and/or distance. As to any such filing, the requirements in subsection (1) of this section for the commission to act on that filing within ten months from the date the filing would otherwise go into effect are suspended under this subsection from the effective date of this 1984 act until June 1, 1985. This subsection shall not apply to any service such as land, marine, or air mobile service, or any like service that has traditionally been offered on a measured-service basis.

NEW SECTION. Sec. 3. This act is necessary for the immediate preservation of the public peace, health, and safety, the support of the state government and its existing public institutions, and shall take effect immediately.

ENGROSSED SENATE BILL NO. 4519

State of Washington 48th Legislature 1984 Regular Session

by Senators Williams, Hemstad, Moody, Fuller, Rasmussen, Conner, Peterson, Benitz, Quigg and Haley

Read first time January 16, 1984, and referred to Committee on Energy & Utilities.

AN ACT Relating to telecommunications; amending section 80.16.010, chapter 14, Laws of 1961 and RCW 80.16.010; amending section 17, chapter 216, Laws of 1961 as last amended by section 1, chapter 49, Laws of 1977 and RCW 19.86.170; adding a new section to chapter 80.36 RCW; and creating new sections.

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF WASHINGTON:

NEW SECTION. Sec. 1. The purposes of this act are to:

(1) Make available to all the people of the state efficient telecommunications services at reasonable and affordable charges;

(2) Rely, whenever possible, on competition, rather than regulation, to determine the variety, quality, and cost of telecommunications services and to promote the development of such competition;

(3) Promote diversity in the supply of telecommunications and information services; and

(4) Ensure that users of regulated telecommunications services and facilities pay only reasonable and nondiscriminatory charges and that such charges do not include costs associated with the competitive activities of regulated telephone companies.

NEW SECTION. Sec. 2. There is added to chapter 80.36 RCW a new section to read as follows:

(1) The commission shall have the authority to discontinue tariff filing requirements for any service, product, or facility upon receiving a petition for detariffing from any regulated telephone company. The commission, upon receiving any petition for detariffing, shall provide public notice and an opportunity for public comment during a thirty-day period following such notice. The commission may set forth specific requirements for additional

Attachment 2, Page 2

information or justification from the telephone company. As soon as practicable but, in any event, not later than ninety days after the date of filing of the petition, the commission shall make an initial determination about whether to detariff. Whenever the commission has required additional information it shall extend such period for not more than ninety days from the date of its request for additional information. The commission may order detariffing of any product, service, or facility, only if it finds that vendors or suppliers unaffiliated with the petitioner are providing a comparable or substitute service, product, or facility in a defined competitive market within the state; and that the offering by a telephone company of a detariffed service, product, or facility shall not result in the cost of that service, product, or facility being subsidized by revenues derived from customers of the telephone company's tariffed services, products, or facilities. Any commission order detariffing services, products, or facilities shall contain a detailed statement of the basis and purpose for the commission's decision.

(2) A telephone company proposing to offer a service, product, or facility on a detariffed basis shall provide to the commission substantial evidence that vendors or suppliers unaffiliated with the telephone company are providing a comparable or substitute service, product, or facility in a defined competitive market within the state; and that the offering by the telephone company of such detariffed service, product, or facility shall not result in the cost of that service, product, or facility being subsidized by revenues derived from customers of the telephone company's tariffed services, products, or facilities.

(3) The price charged by a regulated company for a detariffed service, product, or facility shall not be lower than the cost of providing such service, product, or facility. The offering by a telephone company of a detariffed service, product, or facility shall not result in the cost of that service, product, or facility being subsidized by revenues derived from customers of the telephone company's tariffed services. The commission shall apply appropriate cost accounting standards to implement this section.

(4) Upon its own motion or complaint of an interested party, the

commission may review the prices charged by any telephone company for any competitive product, service, or facility that is detariffed under this section and may retariff any product, service, or facility if it finds a lack of competition.

(5) The commission, for purposes of adjusting its regulatory supervision to prevailing market and industry developments and conditions, shall establish criteria to be used in detariffing services and facilities under this section. Such criteria shall include but shall not be limited to considerations of market dominance and market share.

NEW SECTION. Sec. 3. There is added to chapter 80.36 RCW a new section to read as follows:

No telephone company may use current revenues earned from that portion of its business which is regulated under this title to subsidize activities which are not regulated under this title, nor shall revenues from any activity not regulated under this title, except revenues actually derived from the sale of directory advertising or directory publishing rights, be attributed to the regulated activities of a telephone company for any purpose.

Sec. 4. Section 80.16.010, chapter 14, Laws of 1961 and RCW 80.16.010 are each amended to read as follows:

As used in this chapter the term "public service company" shall include every corporation engaged in business as a public utility and subject to regulation as to rates and service by the utilities and transportation commission under the provisions of this title, with the exception of telephone companies as defined in this title.

As used in this chapter, the term "affiliated interest" means:

Every corporation and person owning or holding directly or indirectly five percent or more of the voting securities of any public service company engaged in any intrastate business in this state;

Every corporation and person, other than those above specified, in any chain of successive ownership of five percent or more of voting securities, the chain beginning with the holder of the voting securities of such public service company;

Attachment 2, Page 3

Every corporation five percent or more of whose voting securities are owned by any person or corporation owning five percent or more of the voting securities of such public service company or by any person or corporation in any such chain of successive ownership of five percent or more of voting securities;

Every corporation or person with which the public service company has a management or service contract; and

Every person who is an officer or director of such public service company or of any corporation in any chain of successive ownership of five percent or more of voting securities.

NEW SECTION. Sec. 5. There is added to chapter 80.36 RCW a new section to read as follows:

Whenever the commission shall find that any other corporation or person either exercises, or is in position to exercise, by reason of ownership or control of securities or for any other cause, any reasonably substantial control over the business or policies of any telephone company engaged in business in this state, the commission may order that the burden of proof shall be upon such telephone company to establish the reasonableness, fairness, and absence of injurious effect upon the public of any fees or charges growing out of any transaction between such telephone company and such other corporation or person. If any telephone company fails to prove the reasonableness, fairness, and absence of injurious effect upon the public of such fees or charges, after being ordered so to do by the commission, the commission may disallow such fees or charges for ratemaking purposes.

The commission may utilize such tests as it deems appropriate for determining the reasonableness of such fees or charges by telephone companies: PROVIDED, That in a showing that any such telephone company transaction or payment is at a fair price in a competitive market it shall be prima facie evidence that such fees or charges are reasonable.

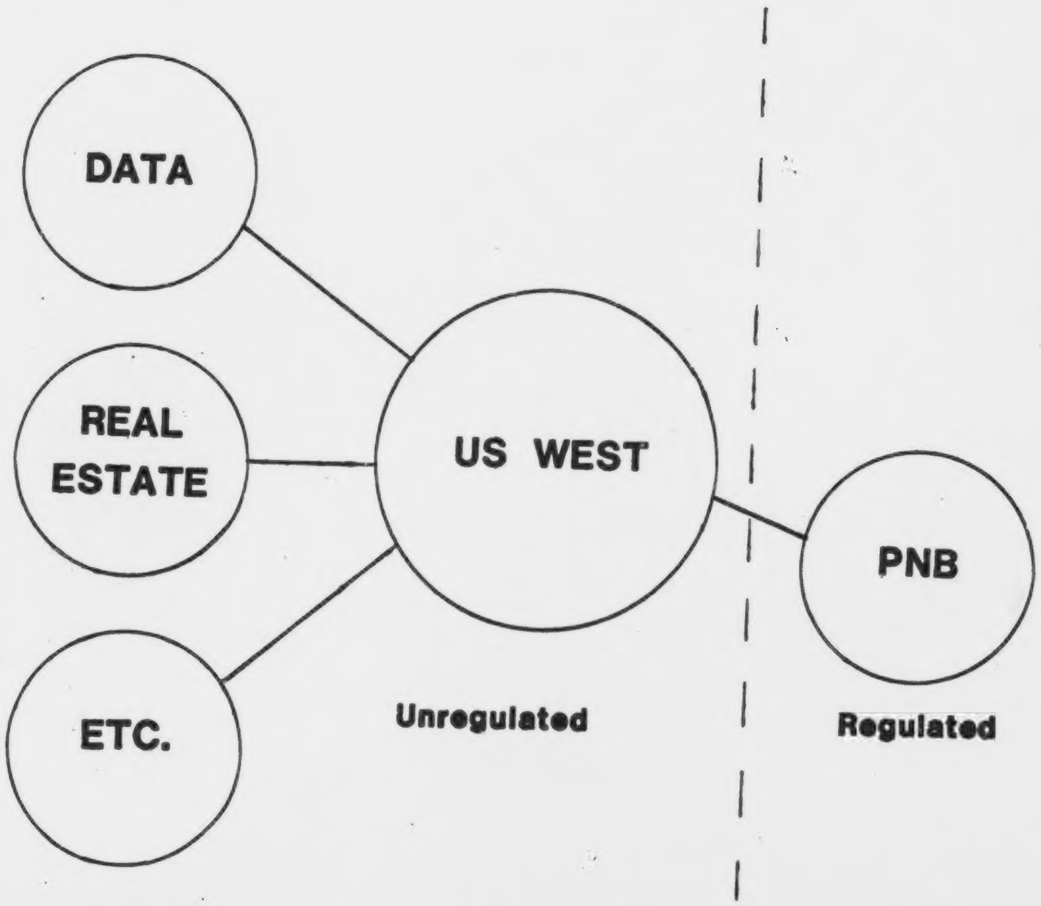
Sec. 6. Section 17, chapter 216, Laws of 1961 as last amended by section 1, chapter 49, Laws of 1977 and RCW 19.86.170 are each amended to read as follows:

Nothing in this chapter shall apply to actions or transactions otherwise permitted, prohibited or regulated under laws administered by the insurance commissioner of this state, the Washington utilities and transportation commission, the federal power commission or actions or transactions permitted by any other regulatory body or officer acting under statutory authority of this state or the United States: PROVIDED, HOWEVER, That actions and transactions prohibited or regulated under the laws administered by the insurance commissioner shall be subject to the provisions of RCW 19.86.020 and all sections of chapter 216, Laws of 1961 and chapter 19.86 RCW which provide for the implementation and enforcement of RCW 19.86.020 except that nothing required or permitted to be done pursuant to Title 48 RCW shall be construed to be a violation of RCW 19.86.020: PROVIDED, FURTHER, That actions or transactions specifically permitted within the statutory authority granted to any regulatory board or commission established within Title 18 RCW shall not be construed to be a violation of chapter 19.86 RCW: PROVIDED, FURTHER, That this chapter shall apply to actions and transactions in connection with the disposition of human remains: PROVIDED FURTHER, That this chapter applies to any actions and transactions of any telephone company operating in the state when such actions and transactions are conducted on a detariffed basis or by an unregulated affiliate.

RCW 9A.20.010(2) shall not be applicable to the terms of this chapter and no penalty or remedy shall result from a violation of this chapter except as expressly provided herein.

NEW SECTION. Sec. 7. If any provision of this act or its application to any person or circumstance is held invalid, the remainder of the act or the application of the provision to other persons or circumstances is not affected.

Attachment 3


DATA
REAL ESTATE
ETC.
US WEST
PNB
Unregulated
Regulated

Impact of Affiliated Interest Provisions of SB 4519

Attachment 4

Example: ABC Telco Purchases Data Processing Services from an Affiliated Interest

Item	Fair Market Cost	Costs Included in Rate Making		Profit Included in Allowable Rate of Return	
		Now	SB 4519	Now	SB 4519
Cost to produce service	$20.	$20.	$20.	$0.	$0.
Administrative overhead	5.	5.	5.	0.	0.
Marketing cost	5.	0.	5.	0.	0.
Profit	4.	0.	4.	4.	0.
Totals	$34.	$25.	$34.	$4.	$0.

Increase in costs:

Costs increase $9 in calculating rate base

Increase in telephone rates:

Laws provide for the telephone company to receive an allowable rate of return
For the sake of this example, we will assume an allowable rate of return of 11%

Calculation:

Under existing law, the telephone rate needed to support the $25 cost is:
$25 x 1.11 = $27.75

Under SB 4519, the telephone rate needed to support the $34 cost is:
$34 x 1.11 = $37.74

Increase in telephone rates due to SB 4519: $9.99

Attachment 5

Loss in Allowable Rate of Return:

As indicated above, there is a reduction of $4 in the contribution to the allowable rate of return. The chart below indicates the relative impact on telephone rates assuming the above example. The percentage of affiliated interest indicates the total amount of the rate base that is provided by affiliated interests under SB 4519 using the same relative cost relationships as shown above:

% of Total Costs Provided by Affiliated Interests	Increase in Costs in Rate Base	Reduction in Contribution To Allowable Rate of Return	Resulting Rate Increase
10%	3.6%	10%	5.1%
20%	7.2%	20%	10.2%
30%	10.8%	30%	15.3%

Prepared by:

Independent Business Association

Mr. **Wyden**. Thank you very much. I think we will have all the panel members make their presentations, and then we will have questions.

Mr. Bernau.

TESTIMONY OF JIM BERNAU, DIRECTOR OF GOVERNMENT RELATIONS, NATIONAL FEDERATION OF INDEPENDENT BUSINESSES/OREGON

Mr. **Bernau**. Chairman Wyden, Congressman Swift, and Congressman Skelton, welcome to the Pacific Northwest. I won't duplicate comments made by Gary and get right to the heart of the matter on measured service.

But I would like to point out that remarks made by Chairman Wyden are true, but as a business association, it took us a little while to learn about it. Our members frankly surprised us. When we did a survey of our members in Oregon and asked their top concerns, the cost of telephone service ranked in the top 10.

If any of you are familiar with—of course, I know Congressman Wyden is—with Oregon property and personal income tax structure, the cost of telephone service in Oregon to Oregon business owners ranked above tax issues in terms of problems. That is what kind of a problem it is for consumers.

I appreciate the remarks you made about access fees. Oregon members, of which we have about 13,500 in Oregon, are very concerned about this. The average size of our members is about seven employees per business, although some businesses range up to several hundred employees in size because they are small lumber companies, but this is an extremely important issue to our members.

The NFIB in Washington has filed with the FCC to ask the FCC to exempt the first six lines from the $6-per-line charge. I don't know what success they will have, but all I can do is ask you, on behalf of Oregon members, to proceed as best you can in eliminating this unfair tax on small business owners.

I know that the NFIB has given you information that shows that small business owners make a great deal of local calls and not a great deal interstate, long-distance calls, so over time there will be billions of dollars of capital that will transfer from the hands of small business owners into the hands of America's larger corporate giants because of the way in which they use telephones.

The whole issue in Oregon on deregulation that was presented by Pacific Northwest Bell to the public utility commissioner was one we need to move to cost-based pricing. That is what they said the whole industry was going through, and, of course, the $6 charge, which had nothing to do with cost-based pricing, contradicted that.

But in addition, the measured local service billing plan that PNB submitted to the public utility commissioner in Oregon contradicted that policy as well. This wasn't cost-based pricing that they were advocating at all. We found incredible contradictions in their statement of public policy and what actually occurred.

With Congressman Wyden's help, we did what was almost viewed by everyone in Oregon as impossible. After the commissioner granted the request for local measured service, we were able to get that order delayed until July 1985, which mirrored the actions that took place in Washington, and we relied on what happened here to delay until it can be examined in Washington.

We found that the cost of hunts, the ability for lines to hunt up the next available line, the PNB said the actual cost for providing that service is 90 cents per line; yet in the first proposal, they wanted $14 per line per month from Oregon businesses. Of course, we had no ability to go and shop for a hunting feature from another company.

After we discovered how little it cost, they dropped their rate proposal to $10 per line, but that wasn't much of a consolation, given the fact that a small business with only five lines was going to be paying $40 or $50 per month just for this feature of hunting that currently is in our basic cost.

The feature of call forwarding costs $4.25 per line per month. In a move to cost-based pricing, you would think it would go down, but in this feature they asked for that amount of money, and yet it costs 25 cents per line per month.

We wondered how is this cost-based pricing? It really isn't. It was what this rate proposal did under measured service, which by unbundling these very features, like the call forwarding and the hunting features, they charged a great deal more than what their cost was. And that created a whole new set of subsidies.

We were going from a system of old subsidies to another system with new subsidies. This is something that we strongly objected to. We didn't really know how to evaluate the cost per call. They wanted to charge us 5 cents per minute for a call up to 8 miles in the local area and 2 cents per additional minute. We didn't know how to evaluate that, but we knew that they didn't know what the cost of the line was; they told the PUC that.

We knew they wanted to depreciate the switching equipment over a 5-year period when experts said it should last 15, and that was in the rate proposal, and we knew that their switching equipment was discovered by the PUC to be much higher than other local telephone companies-owned switching equipment. So there was a question whether that should be included in the rate base.

So here are some of the problems we faced. On top of that, they wanted to charge us—for example, for a 65-second call, you will get billed for 2 minutes' worth of usage, not 65 seconds. For 125 seconds, you get billed for 3 minutes. So this rounding up created additional revenue of $3.7 million rather than actually billing according to what we felt was much closer, like tenth-of-a-minute billing.

Business owners are comfortable with the idea of paying for what they use. Cost-based pricing seemed to make sense if it was phased in over a period of time where no business would be affected, especially where marketing and accounting ideas were based upon the idea of universal service.

But that is not what we got. Fortunately, we were able, with the help of Congressman Wyden, to stop this. We learned yesterday from Ed Morrison, a staff member at the public utility commission, and I don't have this included in my testimony. He said that it is almost impossible for him to figure out exactly what PNB's costs are because all the data he gets from them is useless because of the accounting system that they use. They don't have to abide by generally accepted accounting practices. They use a 1911 derivative of the railroad accounting methods.

Ed Morrison said that the only way we can solve this problem to give public utility commissions better data is to make sure they have the proper information, and that is something that maybe Congress can do. I know that many other issues will be covered, so I thank you very much for coming and helping us with this problem.

[Mr. Bernau's prepared statement follows:]

PREPARED STATEMENT OF JIM BERNAU, DIRECTOR OF GOVERNMENT RELATIONS, NATIONAL FEDERATION OF INDEPENDENT BUSINESSES/OREGON

Owners of small businesses in Oregon ranked the cost of telephone service among the top 10 most critical problems they face on a recent NFIB survey. Among a list of 72 problem areas, telephone costs were ranked above property and personal income taxes by our members.

Recent regulatory actions by the FCC and the Public Utility Commissioner in Oregon have resulted in the greatest letter writing effort ever made on any issue by our Oregon members. This is a clear measure of the business community's concern.

"Access Fees"

We have been told by the regulators and the telephone companies these changes are a result of pricing telephone services according to cost. Recent regulatory actions contradict these statements of public policy.

The $6.00 per line per month charge imposed upon businesses with more than one line is not cost-based. Businesses must pay this extra cost regardless of their interstate long distance use. This method of raising replacement revenue for local telephone service providers has resulted in much higher phone costs for small businesses and an indirect transfer of capital from small businesses to America's corporate giants.

As you know, the NFIB has petitioned the FCC to suspend the access charges for multi-line users with six or fewer lines or at least reduce the charge until a fairer system of allocating costs can be devised.

Mandatory Local Measured Telephone Billing for Business

In Oregon, the PUC has granted a delay in mandatory local measured telephone billing for business until July 1, 1985. This delay was granted after months of intensive lobbying by business associations and strong protests from Oregon political leaders, including Chairman Wyden.

No quarrel has ever been made with the the concept of pricing telephone services according to cost. Business owners are taking issue with the way the local measured service rates are structured and how they are to be implemented.

A broad-based group of business organizations representing homebuilders, realtors, hospitals, newspaper publishers, radio broadcasters, manufacturers, motel and hotel owners, personnel agencies, telephone answering services, travel agents, collection agencies, accountants, attorneys, insurance, banking and the financial services industry, retailers, auto dealers, and others asked for the same consideration that Washington businesses were given - a delay in implementation of local measured service until July 1, 1985 and an independent study of local measured service issues.

Non-profit charitable organizations, local governments and other public agencies joined with us because their budgets are set far in advance and could not adjust quickly to radically higher costs.

We asked for 8 regional public hearings in the proposed rate structure. Only one day of hearings were conducted in Portland and only six working days after the PUC rate recommendations were made public.

We asked for billing comparisons to be provided to businesses for a period of six months before the new rate schedule goes into effect so business can intelligently plan and change personnel practices, marketing strategies and telephone equipment based upon those rates. No billing comparisons were required to be mailed to businesses by PNB.

We asked for a 5 year phase-in of the new pricing system. A $15 per line per month cap on increases was granted. This cap was to have been reviewed in early 1985.

We asked that businesses in PNB's territory not be placed at a competitive disadvantage with those in GTE's where measured service will not be in effect for at least a year. Waiting a year would have solved this problem, but the commissioner didn't even comment on this issue.

PNB customers will be charged for local calls to access alternative long distance networks such as MCI, Sprint, etc. Customers using AT&T Long Distance will not be charged because a local call is not required to use their network. This competitive problem between long distance providers was ignored.

The cost of lines has not been determined. The costs of PNB's switching equipment is believed to be unnecessarily high - yet no study has been made of this surprising and revealing finding. The rates are based upon replacing that equipment every five years when experts believe the average life of the equipment will last at least 15 years.

Both PNB's rate filing and the PUC's order on local measured service rates violate the very principles upon which this move to cost-based pricing is based.

1. The cost of "hunting", the ability for incoming calls to hunt to the next available line, will be priced at $7.00 per line per month. The actual cost is less than 90 cents. Currently, hunting is part of the basic service.

2. The cost of the call forwarding feature will range from $3.25 to $4.25 per line per month. The actual cost is 25 cents. More importantly, if the caller is a business in PNB's service area, their call will be measured and charged as well as the business they are calling - double billing of a single call.

3. Calls made for less than a minute will be charged as if they are a full minute call just as calls of over a minute will be charged by rounding-up to the next full minute. The whole idea of measured service is to give telephone users the incentive to use the telephone network as efficiently as possible, yet this "rounding-up" creates as disincentive to minimize the length of the call. PNB will collect $3,709,000 more yearly than if calls were charged by rounding-up to the nearest 1/10th of a minute.

4. Three usage pricing options will be available; light, moderate, and heavy. Discounts will be provided for moderate and heavy use. Since businesses' local calling varies from month to month it would be wise for them to select each month the billing option that is least costly. PNB will automatically select the best usage discount for a particular month for an additional charge of $2.50 per line per month. No attempt has been made to find out if this charge is cost-based. Additionally, PNB will receive revenues for services they don't deliver unless the business accurately determines each month which pricing plan best matches their use.

In PNB's and the PUC's rush to implement local measured service, many Oregon businesses would have been hurt - unnecessarily. Fortunately, we succeeded in getting a one year delay. Now, we must encourage the PUC to do its homework and design a rate structure that fairly allocates costs among subscribers.

APPENDIX

Summary of PUC Order No. 84-442, UT17 Relating to Local Measured Telephone Service for Business Customers

Summaries of present prices and the local measured service (LMS) rate structure and pricing options are listed below. A comparison of LMS to Key and PBX current prices is also included.

Present Monthly Line Prices

*Single line flat rate	$38.65
*Key line flat rate w/ hunting	56.35
*PBX line f;at rate w/ hunting	72.25
*Key line, measured service	32.70

New Monthly Line & Hunting Prices

*Business Line w/out hunting	$32.25
*Hunting per line	7.00
*Conditioning per line	5.00

Local Usage Charges

In addition to line charges, customers will be billed for "local usage" as they are currently billed for long distance calls. These local toll charges are based on four factors:

1. Time of day the call is made*
2. Length of the call (total minutes consumed)
3. Number of calls made
4. Distance the call travels

*35% less during off-peak hours

Usage Rates

Distance	Initial Minute	Each Additional Minute
0-8 miles	$.05	$.02
9-12	.055	.025
13-16	.06	.03
17-over	.065	.035

Usage Measurement

Usage will be measured by rounding the time of each call up to the nearest minute. That is, a call lasting 5 seconds will be billed for 60 seconds and a call lasting 65 seconds will be billed for 120 seconds. On behalf of our members we, together with other organizations, supported the 10th of a minute billing concept. The type of measurement system approved in the order is inequitable and should be revised as soon as possible.

Billing Options

Light User-	$32.25 line rate plus usage
Moderate User-	$32.25 line rate plus $15 for $18 usage
Heavy User-	$32.25 line rate plus $23 for $27usage plus tapered discount up to 20%

Bill Cap

For an unspecified period of time the total charge for a line and its usage shall not exceed $15 over the present flat rate. As an example, a key telephone (multi-line) customer presently pays $56.35 per line per month. This same customer will pay no more than $71.35 per line per month as long as the bill cap is in effect. The Commissioner estimates that this cap will apply to only 10% of PNB's customers. We had requested a five-year transition plan with gradually increasing caps which would be eliminated in the fifth year. This would give business, government and non-profit organizations sufficient time to plan and budget for the increased costs of doing business.

Call Forwarding

The manner in which call forwarding is to be priced does not come close to being cost-based. Call forwarding is used primarily in conjuction with telephone answering services and customers using this feature will be subjected to the questionable practice of double billing or, more correctly, double recovery of usage charges by PNB.

Customers using call forwarding will pay usage charges for calls forwarded to another location, and the caller originating the call will also pay usage charges. The problem with this is that it does not cost PNB twice the amount of one call. The cost to PNB is just slightly more than one call but significantly less than two.

The usage charges are in addition to the recurring monthly charge of $3.25 which was reduced from the present rate of $4.25. The rate was reduced in an apparent attempt to offset the increased usage charges call forwarding customers will have to bear. Unfortunately, this $1 reduction in the call forwarding rate, will not cover the cost of one message per day.

Summary of Rate Comparisons

The rate comparisons listed below include hunting charges and calculate usage based on the most favorable billing option available. Each case shows a sample of the number of calls per day and the average duration of the call in minutes. Costs are total monthly charges. Time of day discounts are not included.

Key (Multi-line) Rates - LMS Rates

	Case 1	Case 2	Case 3	Case 4	Case 5
Avg # Calls	2	6	15	10	35
Avg Time	1	5	4	10	2
Flat Rate	$56.35	$56.35	$56.35	$56.35	$56.35
LMS Rate	$41.45	$56.41	$72.55	$79.26	$84.76
$ Difference	($14.90)	$ 0.06	$16.20	$22.91	$28.41
% Difference	-26.44%	0.11%	28.75%	40.66%	50.42%
LMS w/ Cap	$41.45	$56.41	$71.35	$71.35	$71.35
$ Difference	($14.90)	$ 0.06	$15.00	$15.00	$15.00
% Difference	-26.44%	0.11%	26.62%	26.62%	26.62%

PBX Flat Rates - LMS Rates

	Case 1	Case 2	Case 3	Case 4	Case 5
Avg # Calls	6	12	5	40	65
Avg Time	5	7	30	5	1
Flat Rate	$72.25	$72.25	$72.25	$72.25	$72.25
LMS Rate	$56.41	$78.89	$98.62	$127.77	$100.60
$ Difference	($15.84)	$ 6.64	$26.37	$55.32	$28.35
% Difference	-21.92%	9.18%	36.50%	76.84%	39.24%
LMS w/ Cap	$56.41	$78.89	$87.25	$87.25	$87.25
$ Difference	($15.84)	$ 6.64	$15.00	$15.00	$15.00
% Difference	-21.92%	9.18%	20.76%	20.76%	20.76%

Mr. WYDEN. Thank you. Both you, Mr. Bernau, and Mr. Smith have spent a good deal of time looking at specific issues that are important to your members, and that is very helpful to us.

Mr. Dodson.

TESTIMONY OF MARK DODSON, ATTORNEY

Mr. DODSON. My name is Mark Dodson, a partner in the law firm of Lindsay, Hart, Neil & Weigler of Portland. I am here to testify principally on measured service. Since Mr. Smith and Mr. Berneau have handled a lot of the impacts of measured service on small business and Mr. Terry will handle impacts on charitable institutions, let me focus on the measured service proceeding from the standpoint of a regulatory lawyer.

In the summer of 1983, several businessmen approached us with some concern about the Pacific Northwest Bell mandatory measured service filing. Many of them had seen what had happened with electricity rates, which were not a significant part of their costs in the early seventies but became a major part of their operating costs by the midseventies. Our law firm had been involved in ratemaking and particularly electricity ratemaking since the midforties, and they were interested in what we thought of the proposal advanced by Pacific Northwest Bell.

We advised these clients essentially to pool their resources, hire independent experts, and make that information available to everyone, to the public utility commissioner, to Mr. Bernau, to other intervenors, as well as to the phone company.

Intuitively measured service makes a lot of sense, and it is very close to ratemaking that we are familiar with in other industries: find out what the cost per unit is and charge by that cost. People have control over their costs, and that ultimately results in conservation.

What was disturbing to us was that Pacific Northwest Bell's measured service proposal wasn't nearly as simple as everyone had thought. As I have said before on many occasions, I think what the phone companies are attempting to do is to duplicate in several months what it took the electric utilities approximately 30 years to do successfully. It is not surprising that we have some of the problems that we are facing at this time.

One of the difficulties is that you can't reach a per-unit cost in the same way that you can for the electric utilities on a per-kilowatt hour basis.

Another problem is that the phone companies offer a virtual buffet of services that are also extremely difficult to price. You either turn on a lamp or you don't with respect to electricity. With respect to telecommunications, a businessman may not even know that he has been totally dependent on the feature of hunting, until the charge for that feature goes up to $14 per line per month, and then he can't afford that feature anymore.

I think the complexity of what was offered is probably the most graphically demonstrated by the fact that the phone company was actually asked to offer what amounts to an insurance policy at an additional cost to a ratepayer to guarantee that the ratepayer will pay the lowest cost to which he is entitled. Imagine charging the phone ratepayer to go to the lowest price to which he is entitled.

A lot of people began to get skeptical just exactly the way Mr. Smith and Mr. Bernau were mentioning, and they were beginning to think that cost-based pricing was actually price-based costing; in other words, the phone company was establishing a price and then going out and determining the cost.

In response to these difficulties, we thought it was very important to have some independent experts analyze what the costs of telephone service are, and to make that information available. This is an incredibly complex issue, and it is going to take a great deal of time to do that. We did, however, engage in at least a preliminary investigation. The results were alarming.

As Mr. Bernau mentioned, for example, in some particular cases the cost of hunting is 12 cents per line; others much higher than that, but I think there is a virtual consensus that the actual cost is no higher than $1 per month per line. To charge $10 or $7 for that same service isn't cost-based pricing. It isn't even cost-related pricing.

So many of the businessmen are asking a legitimate question, which is: What are the real costs a phone company has to pay? What is a legitimate charge for us?

In conclusion, let me say that establishing fair and efficient phone rates based on costs takes a great deal of time analysis by experts. It also takes responsible input from the phone users. I believe that the commissions in Oregon and Washington should be encouraged to study this process before any measured rates are implemented. It is only by giving these complex issues the time and attention they deserve that we can establish telephone rates that have credibility.

I want to emphasize that that is an extremely important factor. I think in Oregon, we got into a bit of an unhealthy situation where people were beginning to question whether the rates were cost-based or not, and you can also allow the businessman the predictability that he needs in order to operate in a post-divestiture era.

Thank you.

Mr. WYDEN. Mr. Dodson, thank you.

Mr. Terry.

TESTIMONY OF GARETT C. TERRY, DIRECTOR OF SOLICITATIONS, ASSOCIATION FOR RETARDED CITIZENS, PORTLAND, WA

Mr. TERRY. I want to thank you personally for all your efforts in the past year that gained us the 1-year delay in measured telephone service. We are all very appreciative.

My name is Garett Terry, and I am the director of solicitations for the Association for Retarded Citizens in Portland. I represent just 1 of over 1,900 local and State units across the Nation. We are the largest volunteer health organization in the country. Our organization and its units are dedicated to improving the lives of mentally retarded persons from all walks of life and all ages.

We are supported by contributions, United Way donations, and proceeds generated through telephone solicitation. Thirty percent of our income comes through telephone solicitation. There is no umbrella agency in Oregon that speaks on behalf of all nonprofit agencies.

I have taken it upon myself to inform these people and see if they are aware of what the impact of measured service is going to be on them. Because of the complexity of the statement we got in August and October of what our bill is going to be, many of the people just threw this away. They weren't able to read it.

I found it pretty complex to understand. I am concerned that a lot of these agencies are not aware of what the impact is going to be on them. In particular, the agencies that depend on telephone soliciting are going to be the ones hardest hit.

During 1983, over $125,000 was generated as a direct result of soliciting the Portland and Salem area alone. The cost of telephone service to generate those funds was approximately $8,000. Under local mandatory measured service as proposed by Pacific Northwest Bell last year, the same service would have cost my organization an additional $30,000 a year. Implementation of that service is going to reduce essential income from this source by 25 percent.

We have no budget provisions to make up for this loss. We receive no Government funding nor do we expect any increase in other contributions to cover this increase. We are, therefore, left with no choice but to absorb the cost which will, in turn, significantly reduce the number of clients that we can help.

There are approximately 40,000 citizens in the State of Oregon alone classified as mentally retarded. Statistics show that mentally retarded people who receive training will contribute $10 in income taxes for every dollar spent on his or her education. On the other hand, if just one of those persons has to be institutionalized because of lack of that training, the cost can run as high as $100,000 during his or her lifetime to keep that person.

We are only one of many social service and nonprofit agencies throughout the State that depend on the telephone. I can't speak for all of them, but I think that their opinions probably are fairly close to mine. We depend on the phone for many reasons. More importantly, we depend on it to provide the services to those people that need us the most.

The proposed access charges are equally as devastating to elderly persons on fixed or low incomes and to the mentally or physically handicapped persons throughout the State. Most of these people live at or below the poverty level. Many do not have autos and cannot drive, making the telephone an absolute lifeline necessity for information and assistance.

I understand that some of the rate changes being recommended are aimed at charging people in relation to their phone usage. This sounds reasonable, but can have a highly punitive effect on the most needy of the citizens. If measured service is inevitable, I hope that the rates proposed are considerably fairer than the ones we have been stuck with.

As changes are made throughout the phone system, I ask that those in control of the situation do not lose sight of the individuals in our society that are of the greatest need and those agencies that serve them. I appreciate your time very much.

[Mr. Terry's prepared statement follows:]

PREPARED STATEMENT OF GARETT C. TERRY, DIRECTOR OF SOLICITATIONS, ASSOCIATION FOR RETARDED CITIZENS

The Association for Retarded Citizens is grateful for this opportunity to communicate personally with you on the issue of measured telephone service and access charges.

It should be understood that I present this testimony as a representative of one of many ARC units across the state and across the nation.

Briefly, the ARC is a nation-wide, non-profit organization comprised of local community grass-roots units. We are dedicated to improving the lives of mentally retarded persons of all ages, from all walks of life. Our organization and its units are supported through private contributions, United Way donations and proceeds generated through telephone solicitation. This latter solicitation accounts for close to 30% of our annual budget.

Unfortunately, there is no one umbrella agency in Oregon that speaks on behalf of all not-for-profit agencies. It is my concern that many of these agencies may not be aware of the serious adverse effects that the proposed changes in the telephone system may have on them. In particular, those agencies who depend on the telphone to canvass the community for monies or merchandise will no doubt be dealt the most serious blow.

During 1983, over $125,000 was generated as a direct result of soliciting the Portland/Salem area via telephone. The cost of telephone service to generate those funds was approximately $8,000. Under mandantory local measured service as proposed by Pacific Northwest Bell, the same service will cost an additional $30,000. Implementation of measured service will reduce essential income from this source by 25%. We have no budget provisions to make up this loss. We receive no government funding, nor do we expect any increase in other contributions to cover this increase. We are therefore left with no choice but to absorb the cost which will in return significantly reduce the number of clients that we can help.

We are only one of many social service and non-profit agencies throughout the state that depend on the telephone, not only for generating funds, but more importantly to provide immediate and timely aid to the more vulnerable citizens in our society.

In addition, the proposed access charges are as equally devastating to elderly persons on fixed or low incomes and to the mentally or physically handicapped persons throughout the state. Most of these people live at or below the poverty level. Many do not have auto's and cannot drive, making the telephone an absolute life line of information and assistance.

We understand that some of the rate changes being reccommended are aimmed at charging people in relation to phone usage. This sounds reasonable, but this can have a highly punitive effect upon the most needy of our citizens for whom the telephone is their only way of getting help.

If measured service is inevitable, I would hope that the rates are considerably fairer than the ones currently proposed. Such a limitation would reduce the seriousness of the impact.

As changes are made throughout the telephone system, we collectively ask that you do not lose sight of the individuals in greatest need and the agencies who serve them.

Sincerely,

Garett C. Terry

Garett C. Terry
Director of Solicitations, ARC

Mr. WYDEN. Ms. McCleary.

TESTIMONY OF WHITNEY McCLEARY, MEMBER OF THE BOARD, PUBLIC INTEREST RESEARCH GROUP

Ms. McCLEARY. I am here representing the Washington Public Interest Research Group, and we would collectively support everything that has been said so far. My testimony takes a slightly different turn.

WashPIRG first got involved in telecommunication issues 10 months ago for several reasons: We felt that affordable, accessible phone service was vital to our society and we wanted to advocate strongly a State policy of universal service; we questioned many of the economic arguments the phone companies used to promote their proposals; and we wanted to challenge the speed and direction of the phone companies' proposals and their complete disregard of the potentially adverse impacts of these plans.

All of these points are crucial to a discussion of the three issues I will address today: The impact of local measured service on elderly telephone subscribers, the impact of access charges on the elderly, and the impact of mandatory measured service on small businesses.

The term "elderly phone subscribers" obviously applies to an economically diverse group. In addition, the elderly live in a wide range of social situations, having varying degrees of mobility and varying health problems. Nevertheless, it is widely recognized that a significant percentage of the elderly in this country live on small, fixed incomes and in relatively isolated circumstances. This group of seniors depends on phone service for a sense of security and of connection with the world.

This section of our senior population will be severely impacted by a continual rise in the cost of telephone service. In order to afford phone service, they will be forced to cut other expenses such as food, clothing, and entertainment; or they will be forced to stop having a phone altogether or to switch to local measured service in order to control their phone costs.

Last spring, WashPIRG conducted a survey of nine senior centers in King County in an effort to assess the impact of access charges and other phone rate increases on the elderly, particularly those elderly who live on small, fixed incomes. The study was deliberately narrow and exploratory. It was meant to support or disavow three broad hypotheses and suggest the need for and direction of further research.

The three hypotheses were, first, that the telephone has a generally high value to the elderly; second, that nevertheless, demand is elastic and high dropoff with increased rates is likely; and, third, that the use value of the telephone is greater than its monetary exchange value.

The first and third hypotheses were supported by the response to such questions as "Do you feel the phone is essential as a lifeline?" and "Does the phone give you a sense of security?" In response to the lifeline question, 13 percent said it was their sole means of communication with the outside world, 48.6 percent said it was their primary means. And 73.3 percent of those surveyed said that the phone very much gave them a sense of security. This response is even more significant if you consider that the senior citizens we surveyed are healthier and more mobile than the average.

The second hypothesis, that demand is elastic and high dropoff likely, was supported by the response to questions about price increases. WashPIRG researchers asked the seniors if they would keep their phones if prices increased by $6 a month and by $12 a month. Forty-four percent said they would not keep their phone if the bill went up $6 a month and 63.6 percent said they would not keep it if prices increased $12 a month. Yet we know for a fact that if implemented, inter- and intra-state access charges alone will raise monthly phone bills at least $12 a month.

I have a chart to try to dramatize this graphically, what the dropoff would be, given what the response was as far as dropoff. If phone rates went up $2, 11.3 percent would drop off. At $6, 44 percent and at $12, 63.6 percent. We know in the next decade intrastate access charges alone will go up that much if all stays as is.

In effect, then, we are exiling a significant section of our population from mainstream communication unless we make some deliberate choices.

The phone companies' response to this problem is to interpret universal service as only universal access to a phone and to offer a lifeline, measured service option to those who can't afford the residential flat rate. Our survey showed, however, that 56.6 percent of those surveyed make two or more calls per day and 84.8 percent spend 5 or more minutes per day on the phone. Under the terms of the measured service option, these people would have to cut their calling drastically to keep their phone bills low. This system allows seniors the security of having a phone in case of any problems but deprives these less mobile people of a prime means of communication.

There are two interrelated ways to deal with this problem. One is to decide as social policy that universal service is vital to our way of life, that it is more than just access to a phone, and that steps should be taken to protect people unable to afford the dramatic increases in phone rates forecast for the next decade.

A second way is to challenge some of the economic arguments supporting these rate increases. Are access charges, for example, a fair way to recover the revenues lost by splitting up the Bell System? Should all end users pay for the revenue loss, or should the people who use long-distance and the carriers who offer competitive long-distance service pay for their use of the system? It is interesting to note that 77.7 percent of the seniors surveyed would prefer to pay more for long distance and less for local calls.

One can also challenge the cost underpinnings of local measured service. The phone companies argue that the price of services should reflect their true costs and that subsidizing different services, such as local calling, is unfair. Yet no one, not the FCC, the phone companies, or any independent parties, has ever been able to create an adequate cost allocation system for telecommunications. When the phone company says that a 3-minute call placed during the day within an 8-mile band costs 8.1 cents, what does that mean? What costs are being allocated to this call?

This brings me to the third issue I would like to address: The effect of mandatory measured service on small businesses. According to an August 6 issue of the Seattle Business Journal, phone costs for small businesses have already risen an average of 30 percent in the past year in this area. Under a policy of mandatory measured service, these costs are likely to rise even more rapidly with severe impacts on both businesses and the community.

Currently the flat rate for telephone service for small businesses is $38.14. Pacific Northwest Bell proposes to start charging a flat rate of $18.54 and then 5 cents for the first minute and 2.5 cents for each additional minute of calls within a given eight-mile band. We did some simple arithmetic and determined that twenty 1-minute calls alone times 20 business days per month would mean a $39.54 phone bill which is already $0.40 more than the present flat rate, and this is a relatively small amount of calling.

Furthermore, PNB, despite its argument against subsidization in pricing, has proposed giving large volume callers a discount. In round figures, PNB claims that it costs them 8.1 cents to handle a 3-minute call during peak calling hours. But PNB proposes charging large-volume users 8.0 cents for that 3-minute call and charging small-volume callers 10.0 cents for the same call. While some small businesses may qualify as large-volume users, a great majority will not but will instead be subsidizing larger businesses.

Essentially, the phone companies are afraid of competition and will do whatever is necessary to prevent bypass. In their proposal for mandatory measured service, PNB wishes to keep phone rates down for large users who might bypass at the expense of small business.

WashPIRG is very aware of the potential impacts of bypass, of the cost to the monopoly ratepayer of stranded investments. But we find the potential for individuals and small business being forced either to have a phone which they can't afford to use or to get off the system altogether much more serious. We live in a society which is exceptionally dependent on the phone for communication.

Furthermore, a phone is valuable not only to the person who can call out but to those people who can call you. I do not believe that people are considering what it will mean to business, to political campaigns, and to other community events to have people drop off our main system of communication. WashPIRG strongly urges you to challenge the phone companies' proposals, to question their system of accounting and their justifications of their plans, and to support a continued policy of universal service.

Thank you very much for your time and attention.

Mr. WYDEN. Thank you very much.

[A report submitted by the Public Interest Research Group follows:]

An Investigation Into the Implications of Telecommunications Policies for Washington State's Senior Citizens.

June 1984

A Report by the Washington Public Interest Research Group (WashPIRG)

by: Mary Crichton
Michael Gilbert
Lori Kabron
Kathy Macduff
Debbie Sternberg
with Andrew Cahn and Gerald Pollet

BACKGROUND

Telecommunication controversies are not entirely novel in nature, although the issues at the forefront do have new aspects and some new names. The value structure used in policy decisions, on the other hand, has an old name: universal service. Despite the occassional disputes over the definition of this term, it is nevertheless a sufficient guideline for exploratory research. Therefore this study concerns itself with universal service and an increasingly important population of telephone users: the elderly of Washington State.

Although many of the concepts of contemporary issues may be old ones, their relevant manifestations should be mentioned, particularly those most relevant to this inquiry. Investigatory strategies can focus on supply side or demand side aspects of the issue. The greater aspects of cost causation are an example of the former. Various types of market analysis, such as drop-off, by-pass and this study, are examples of the latter. Issues hinging crucially on such research include access charges, measured service, lifeline rates and rate increases in general. How these and other similar changes in the pricing of telephone service will affect the quality of life of the elderly of Washington state is the express concern of this study.

However, it does not presume to address this concern with the rigor more appropriate to a lengthy and definitive work. This study is deliberately narrow and exploratory. Its conclusions are not answers but should rather suggest avenues of research and questions of importance during the current flux of telecommunication decisions.

HYPOTHESES AND METHODS

In keeping with the exploratory nature of this study, the working hypotheses were fairly broad. First, the telephone has a generally high value to the elderly. Second, nevertheless, demand is elastic and high drop-off with increased rates is likely. Third, the use value of the telephone is greater than its monetary exchange value.

The primary tool used in this study was a survey administered by four researchers to individuals contacted at senior centers in the greater Seattle area. (See Appendix 1 for a complete copy of the survey form.) The three page, 23 question survey was attached to a cover letter which described the purpose of the survey, gave an assurance of confidentiality and provided directions.

Questions 2 - 7 collected some general information about the pattern of telephone usage which was felt might be useful in later analysis. Questions 8 - 12 essentially address the value of telephone service and serve to test hypotheses 1 and 3. Questions 13 - 19 address the issue of elasticity and drop-off and test hypotheses 2 and 3. The final questions address various billing policies and their effect on seniors.

The sampling method involved visiting nine senior centers in King County. These were Northshore Senior Center, Nathan Hale SPICE, Greenwood Senior Center, Norwest Adult Day Care Center, University Christian Church, Stevens Elementary SPICE, Pike Place Senior Center and South Park Senior Center. Data collection was scheduled during meal times when there were the greatest number of people present. Within this population 156 seniors participated in the survey, which represents approximately half the total encountered. Those who could not or would not participate and those who did not have telephones were not included in the sample.

Once collection was complete the data were tabulated. Several questions were crosstabulated to examine the possible correlations.

TABLE 1.

Survey Demographics

Total Completed (n)=156

Sex:

Female = 74%
Male = 26%

Living Situation: (n=143)

	No.	%
Alone:	83	58.0
Not Alone:	60	42.0

TABLE 2.

Results

A. Calling Patterns

Question No.		
2.	Minutes on phone per day? n=51	%
	a. Less than 5 minutes	15.2
	b. 5 - 15 minutes	29.1
	c. 15 - 30 minutes	25.8
	d. 30 - 1 hour	19.8
	e. More than 1 hour	9.9
4.	Local calls made per day? n=156	%
	a. 1 per day or a few per week	38.9
	b. 2 - 4 per day	44.6
	c. 4 - 10 per day	12.1
	d. More than 10 per day	0.0
	No Answer*	4.5

1
38.9
4.5
43.4

*Percent no answering is presented due to potential significance of respondents ability to estimate local calls made per day.

B. Reliance on Telephone

Question No.		
8.	Most important use of phone? n=124	%
	a. Talk to friends/relatives	72.6
	b. Talk to Drs./Hospital/Fire/Police,etc.	21.8
	c. Talk to senior centers/agencies	1.6
	d. Other	4.0
11.	Feel phone is essential as a "lifeline"? n=138	%
	a. Phone is sole way to communicate with outside world	13.0
	b. Primary way	48.6
	c. Use car or bus as much (or walk)	25.4
	d. Use other means more than phone	13.0
12.	Does phone give you a sense of security? n=146	%
	a. Very Much	73.3
	b. Somewhat	18.5
	c. Not much	6.8
	d. Not at all	1.4

C. Policy Implications

Question No.

14. Average Monthly Phone Bill n=126

	%
a. Less than $16	26.2
b. $16 - $25.99	45.2
c. More than $26	28.6

15. If your monthly bill rose by $2 would you keep your phone? n=144

	%
a. Yes	88.7
b. No	11.3

16. If your monthly bill rose by $6 would you keep your phone? n=116

	%
a. Yes	56.0
b. No	44.0

17. If your monthly bill rose by $12 would you keep your phone? n=110

	%
a. Yes	36.4
b. No	63.6

18. If monthly phone bill rose $6, what other expenses would you cut back on? n=122

	%	No.
a. Food	20.5	25
b. Clothing	23.8	29
c. Social/Entertainment	18.0	22
d. Gifts/Donations	22.9	28
e. Drop phone	14.7	18
f. Change to a "metered rate"	17.2	21
g. Would not/Could not cut back	16.4	20
h. Other cutbacks	3.3	4
i. More than 1 of a,b,c, or d	20.5	25
j. More than 1 response - ++1.		36

9. If your billing was switched to Local Measured Service, how would you try to reduce your bill? n=132

	%
a. Less time per call	27.1
b. Make fewer calls	22.0
c. Ask people to call back	6.1
d. All of above	28.8
e. None of above	16.0

19. Would you limit yourself to one 5 minute call per day if it cut your phone bill by one-half? n=122

	%
a. Yes	59.8
b. No	40.2

21. Have you tried Local Measured Service? n=156

	%	No.
a. Yes	9.6	15
b. No	90.4	

22. How long did you try Local Measured Service?
Range: 1 month to several years, many did not recall.

23. Was your phone bill lower under Local Measured Service? n=15

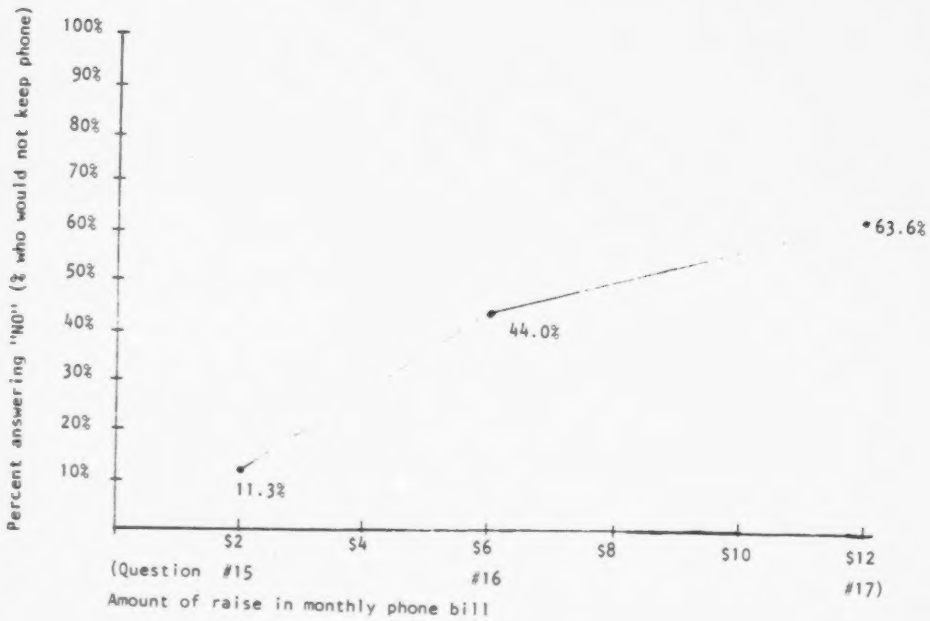
	No.
a. Yes	7
b. No	3
c. No Answer	5

	Make less than 1 local call/day	Make more than 2 local calls/day
Yes	4	1
No	0	3

20. In setting policy, would you prefer: n=121

	%
a. To pay more for long distance and less for local calls?	77.7
b. To pay more for local and less for long distance calls?	22.3

FIGURE 1


Percent answering "NO" (% who would not keep phone)
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
11.3%
44.0%
63.6%
$2
$4
$6
$8
$10
$12
(Question #15
#16
#17)
Amount of raise in monthly phone bill

Difficulties with this methodology will be examined for their impact later. The survey itself had several difficult or ambiguous questions; the sample size for each question therefor varies. Difficulties of sampling were more numerous: minorities were highly under-represented; all the seniors surveyed were urban dwellers; senior centers serve primarily the more social and mobile seniors; frequently seniors would only participate after being assured that the surveyers were not "with the phone company." See Appendix for the survey form actually used.

RESULTS

Table 1 presents the demographic information gathered about the sample. Table 2 summarizes the results of the survey questions. Missing data typically represents the impact of a difficult question or of error in the collection process. Figure 1 illustrates the drop-off pattern inquestions 15 - 17.

The results of questions 11 and 12 are fairly important. Over 60% of the seniors felt that the telephone was their "sole" or "primary" means of communication. Nearly three quarters felt that the phone gave them "very much" sense of security. These lend clear support the hypothesis of high use value of the telephone for seniors.

Despite this value the number of seniors predicting that they would abandon their telephone with increased rates was remarkably high. Complete drop-off would, according to questions 15 -17 (see figure 1), range from 11.3% with a $2 increase to 63.6% with an increase of $12.

Two cross-tabulations were of interest, although they do not directly test the central hypotheses. The first examined the living situation (see table 1) and question 11. The hypothesis for this test was that senior citizens who live alone are more likely to answer that their phone is their "sole" or "primary"means of communication than those who do not. Cross - tabulation provided mild support for this. 69.3% of those who live alone answered a or b, compared with 59.6% of those who do not live alone.

A far more interesting result was produced by the second analysis, which examined questions 14 and 20. The hypothesis was that those with high telephone bills would favor a policy of higher local costs and lower long distance more than those with lower bills. This was strongly supported by the data. 85.2 % of those with low ($16 or less) answered "a". This decreased to 81.8% of those with medium bills ($16 to $26) and to 64.5% of those with high bills ($26 or more). Although it is important to note that a majority of high bill payers still favor a policy of lower local costs, the correlation is strong. (A chi-square test yields a 90% confidence of this distribution applying to the study population as a whole.)

DISCUSSION

That the hypotheses are somewhat supported by the data of this study is evident, but it is also clear that other more thorough examinations with alternative methodologies are in order. The telephone is perceived to be of high value but the exact emotional consequences of being without one is uncertain. When monetary choice must be made, seniors are likely to let the phone go entirely or perhaps decrease the quality of their service somewhat. This latter point is born out in questions 9, 18 and 19. This inconsistency supports hypothesis 3, that use value of the telephone is greater than exchange value. But the study does not explain why this is the case.

The study has flaws and systematic errors which, on the whole, either have no clear effect or, in fact, strengthen the support of the central hypotheses. There are the general flaws of the survey methodology which prevented some potentially useful data from being collected. Possible biases in the respondents' attitudes toward telephone companies present three confusing implications. First, seniors may have guessed the hypotheses and responded accordingly. But, second, if the common objection to participation was a suspicion of the phone company, then the sample may represent a more favorable disposition. Finally, third, there is the presumption that the attitude may not be unwarrented. The final flaw which led to systematic error is the gross sampling method itself. Although the variety of senior centers was fairly high (from Pike Place to Bellevue), the seniors surveyed were overwhelmingly retired, caucasion and mobile. Given these characteristics, a broader sample would be be likely to provide even stronger support for the hypotheses.

The study holds many implications for further research and it was intended to. Methodological improvements to address the systematic errors such as a larger sample size, varied survey techniques, more thorough demographic characterization, etc. would be warrented. Other related avenues should be explored such as the relationship between mobility and telephone dependence, the nature of the high value of telephone service, the importance of use versus access, the attitudes toward the telephone industry and their grounds, the alternatives to drop-off and their impacts, and the nature of the economic environment that causes the elderly to drop-off of a vital service.

Aside from recommendations for further research, the study strongly implies that wise social policy will not increase telephone rates for th elderly. If this survey reflects accurately the situation and behavior of the elderly of Washington state, then increased rates (such as access charges) will result in significant drop-off with corresponding negative impacts on those that lose their telephone. Furthermore, the study suggests that drop-off is multidimensional and that any study which examines only those that leave the telephone network will fail to evaluate the impact of either raised or restructured rates on those that remain. Finally, a very strong policy preference has been voiced by the elderly: that if restructuring of telephone rates is necessary, it should involve a decrease in local rates and an increase in long distance. This strong concern reflects the overwhelming use of the phone system for plain old telephone service by the majority of the elderly and they feel that this should be reflected in public policy.

With 10.4% of this states' population being over the age of 65 (Census Bureau 1983) and with that number growing, it will be important for major decisions to consider the opinions of this group and to thoroughly evaluate the impacts of policies on the elderly.

Appendix A

SURVEY FORM USED
(Size Reduced 55%)

Age ________ Sex (circle) M F

Income/month ________ Total

Soc.Security ________/month optional

SSI ________/month optional

Marital Status (circle your answer) A. Single B. Married
C. Divorced/Widow/Widower

Living Situation (circle best answer) A. Alone B. with spouse
C. group living D. with children

PLEASE CIRCLE ONE LETTER FOR EACH QUESTION UNLESS OTHERWISE STATED.

1. Do you have a phone? Yes No
(If No, please do not fill in the rest of the survey.)

2. How many minutes are you on the phone each eday
   a. less than 5 minutes
   b. 5-15 minutes
   c. 15-30 minutes
   d. 30 minutes - 1 hour
   e. more than 1 hour per day

3. Which of these best describes you?
   a. I make far more calls than I receive.
   b. I receive about as many calls as I make.
   c. I receive far more calls than I make.

4. How often do you make local calls per day?
   a. about 1 per day or a few per week
   b. 2-4 per day
   c. 4-10 per day
   d. more than 10 per day

5. What time of day are most of your local calls made?
   a. before 8 am
   b. 8 am - 5 pm
   c. 5 pm - 11 pm
   d. after 11 pm

6. How often do you make long distance calls?
   a. a few times a week
   b. about once per week
   c. about once per month
   d. primarily on holidays

7. What time of day are most of your long distance calls made?
   a. before 8 am
   b. 8:00 am - 5 pm
   c. 5 pm - 11 pm
   d. after 11 pm

PLEASE CIRCLE ONE LETTER FOR EACH QUESTION UNLESS OTHERWISE STATED

8. What do you feel is the most important use of your phone?
   a. talking to friends/relatives
   b. talking to doctors/hospitals/fire dept./police, etc.
   c. talking to senior centers/agencies
   d. other, specify ________________

9. If you were charged for the length of time per call, and the number of calls you make, how would you try to reduce your bill?
   a. spend less time on each call
   b. lower the number of calls made
   c. ask people to call me back
   d. all of the above
   e. none of the above

10. If you answered a., b., or d., to question 9, to reduce your bill would you cut down on:

(check as many as apply) length of calls to:		(check as many as apply) number of calls to:
________	friends	________
________	relatives	________
________	emergency services	________
________	senior centers	________
________	other, specify	________

11. Do you feel your phone is essential as a "lifeline" to the community? Circle one.
   a. it is my sole means to communicate with the "outside world"
   b. it is my primary means of communication
   c. I use other means such as a car or buses to be with other people just as much
   d. I use my car or buses more than my phone for communicating

Appendix Page 2

12. Does your phone give you a sense of security?
    a. very much b. somewhat c. not much d. not at all

13. Which type of phone billing do you have?
    a. flat monthly rate plus long distance
    b. pay per call, by length of call plus long distance ("metered rate")
    c. "party line"

14. What is your average monthly phone bill? $________

THE PHONE COMPANY HAS PROPOSED A RATE INCREASE OF $2 PER MONTH. OVER THE NEXT THREE YEARS, THE RATES MAY INCREASE UP TO $12.

15. If your monthly bill rose by $2 would you keep your phone? Yes No

16. If your monthly bill rose by $6 would you keep your phone? Yes No

17. If your monthly bill rose by $12 would you keep your phone? Yes No

PLEASE CIRCLE ONE LETTER FOR EACH QUESTION UNLESS OTHERWISE STATED.

18. If your phone bill rose by $6 per month, what other expenses would you cut back on? (circle two letters)
    a. food
    b. clothing
    c. social activities and entertainment
    d. gifts/donations
    e. eliminate the phone entirely
    f. change to a "metered rate" (if not already using it)
    g. If you would not cut down on other expenses, check here ____.
    h. Other, specify ____________

19. Would you limit yourself to making one 5-minute call per day if it would lower your phone bill by one-half? Yes No

20. What would you prefer to pay:
    a. more for long distance and less for local calls?
    b. more for local and less for long distance calls?

21. If you are not currently being charged for length of time per call, did you ever try this billing method? Yes No

22. If you tried this method, for how long did you have it?

    ____

23. When you used this method, was your phone bill lower? Yes No

Thank you for helping with our project!

Mr. WYDEN. Mr. Lindstrom.

TESTIMONY OF GORDON E. LINDSTROM, PRESIDENT, UNITED SERVICES, INC.

Mr. LINDSTROM. Good morning, and welcome to Seattle. I am Gordon Lindstrom, the president of United Services, located in Seattle. Our business is engaged in providing rental equipment to the construction industry in western Washington. For the people who contact us, 99 percent of our business is transacted by phone, a contractor placing equipment with us that we deliver to his job site, making adjustments of that during his construction process and at the conclusion of the job, he contacts us, and we return the equipment to our various yards.

Because we have what we figure is 99 percent of our business transacted by phone, it becomes very important that we handle calls properly, so we have chosen to answer them at our main office in Seattle, and we have accomplished this by utilizing what the telephone company calls remote call forwarding, wherein we have a telephone number, it is assigned in the central office—we don't actually have the instrument anywhere on our premises—we instruct them when the call is dialed what number it is directed to.

Now, this are done in about seven communities in western Washington, all directed down to our Seattle office. And I find on a telephone bill that I have here made an attachment to of a $6 interstate access charge. I see no reason why this charge is applicable to me or to the company, because we have no intent of using interstate communication. I think it is documented by this that we have this. I can't understand why it is. It seems to be an inequitable rate for that.

Thank you.

[Mr. Lindstrom's prepared statement follows:]

PREPARED STATEMENT OF GORDON E. LINDSTROM, PRESIDENT, UNITED SERVICES, INC.

Background:

Our company provides rental equipment to the construction trade through the western portion of our State. 99% of our rental orders are placed by telephone. Because of this fact, we have chosen to have all our telephones answered in our main office in Seattle. To accomplish this we have obtained "remote call forwarding" from the telephone company in each local area we serve. By this system we are provided a local telephone number installed in their central office which when dialed will automatically transfer the call to our main office number in Seattle (285-2191). We presently have this in the following Western Washington cities: Ferndale, Mount Vernon, Tacoma, Bramerton, and Olympia. It can plainly be seen that this telephone activity is solely directed at intrastate communication.

Concern:

The enclosed portion of the telephone bill is for our Mount Vernon telephone number 424-0378 which is on remote call forwarding as described above. I direct your attention to portion showing "service & equipment detail information". As you can see we are being charged $6.00 per month for " business interstate access charge". I believe this charge is certainly not just under this telephone use. I hope that you will remedy this situation.

CONTEL
CONTINENTAL TEL CO OF THE NW
PO BOX [illegible]
MOUNT VERNON WA 98273
BUSINESS OFFICE NUMBER 424-7061

9 1984

002750

BILLING DATE	07-05-84	11
BILLING NO.	428-0378	R
CONNECT DATE	03-05-83	
EXCHANGE NO.	6621	1

UNITED SERVICES INC
3452 16TH AV W
SEATTLE WA 98119

BALANCE FROM PREVIOUS BILL		79.47
PAYMENTS APPLIED THROUGH	06-28-84	79.47
ADJUSTMENTS APPLIED THROUGH	06-28-84	.00
BALANCE		.00
CURRENT CHARGES AND CREDITS		
*SERVICE & EQUIP	07-05 THRU 08-04,	27.15
*LONG DISTANCE CALLS		83.32
*OTHER CHARGES AND CREDITS		8.00

00771000 - 128.41

TAXES

FED	STATE	LOCAL	MISC	
3.55	6.39			9.94

AMOUNT DUE ON OR BEFORE 07-20-84 ***************
* $128.41 *
****

#14164
7/23/84

*SEE ENCLOSED FOR DETAIL INFORMATION

——— SERVICE & EQUIPMENT ———

1	CUSTOM CALL FEATURE	19.35
2	DIRECTORY SERVICE	1.80
1	BUSINESS INTERSTATE ACCESS CHARGE	6.00
	CHARGES FROM 07-05 THRU 08-04	27.15

26

——— OTHER CHARGES AND CREDITS ———

PARTIAL MONTH'S SERVICE FROM 04-30 THRU 07-04	8.00
TOTAL	8.00

AT&T

DATE OF BILL		EXCH	BILLING NO.	CONTROL DATE
07-05-84	10	6621	428-0378	030583 1

Mr. **Wyden**. Thank you. All of you have been excellent witnesses. We could spend forever asking you questions, and we would be here forever.

I will have a couple of questions to start with, and then my colleagues will, as well, on access charges for you. Mr. Smith and Mr. Bernau, it is my understanding, from reading the NFIB materials and other sources, that most small businesses in this country make mostly local calls with a few long distance thrown in, and there is a substantial amount of evidence which would suggest that many businesses, small businesses in this country, are going to pay more in access charges, pay more for the privilege of having the opportunity to make a long-distance call, than they pay for the actual long-distance calls that they make.

Is that your finding and your experience here with Northwest businesses?

Mr. **Bernau**. Chairman Wyden, that is absolutely true. This is incredibly inequitable. I think you said it best. We did quite a bit of research in the field with our field force and acquired this information in one-on-one interviews with our members and so it is good data, and this is absolutely the case, and it is incredibly unfair, and I hope you can help us get rid of this problem.

Mr. **Wyden**. Mr. Smith.

Mr. **Smith**. Mr. Chairman, as you probably understood from my initial remarks, our view of the access charge might be a little different than that of the NFIB. We have a lot of people very concerned about the cost of access charges.

However, in the same breath you have to look at the overall long-term issue. The overriding issue is that if you have the larger customers leave the public network, the public network still has that plant and equipment, the facilities there, and they are under the laws allowed to pay for that equipment and get a rate of return on that equipment.

The major concern is that when those large people leave, the people that are left on the system that can't leave, generally the small businesses, are going to have a significant rate increase.

Now, divestiture was not something that the small business community ran up and said we want divestiture. It is upon us, and if you look down the line at the cost impact on small business, it could be rather significant if you have the major large users leave the local public network.

At that point——

Mr. **Wyden**. I understand your comment about bypass. We are going to talk a lot about bypass. Are you finding that a lot of your members are likely to pay more in access charges than they actually incur in long distance charges?

That is all I wanted to ask in the beginning and we will go on to other things.

Mr. **Smith**. Initially now, yes. In the long term, that is a question.

Mr. **Wyden**. Fair enough. Thank you.

Mr. Terry, one question for you. My understanding is that under the statutes in the Northwest, our charities, our senior citizens groups, for example, like Loaves and Fishes in Oregon, the Elderly Meals Program, Telephone Reassurance, our program where senior citizens are called to make sure they are home, they are considered businesses under the statutes and when there is mandatory service for businesses that applies to them; is that correct?

Mr. **Terry**. That is correct.

Mr. **Wyden**. I have here a memo by the company to your association, the Association of Retarded Citizens, that said as of August 1983 your phone bill was $666.70 a month. Under the measured service proposal that would have gone to $3,551.83 a month for a net difference of between flat and the measured service of $2,885.13. Can you all absorb that?

Could you have kept your doors open had that gone into effect?

Mr. **Terry**. No. We can't. The bottom line is that our clients are the final losers in this issue. We can't provide as many people with the same type of service we have had established for many years.

Mr. **Wyden**. One of the things that I would hope we could all agree on, business, social services, legislators, all of us, is that somewhere along the way we are going to have to figure out a way to treat our charitable, senior citizen groups and others a little bit differently because they can't be treated in the same way as every business, because I think that they are just not going to be able to make it through some of these proposals.

I understand there has been talk in the State legislatures of trying to get an exemption or some kind of different arrangement for the elderly programs and charity programs and others and I would hope that we could get an agreement that somewhere along the way we are going to have to give these organizations a break or else what we are going to see is a lot of these groups that use mostly volunteers are going to close down and there is going to be a greater demand on Government for those services at a time when we have a $200 billion deficit and can't afford it.

One last question for any of you. One of the things that I am told continually is that we don't know telephone company's costs and some people go a step further and say, well, we are not sure that the company knows the company's costs.

How many of you agree with that statement? Raise your hand. Would anybody like to elaborate on that?

Mr. **Smith**. One of the things that we have found out is when you try to get to the issue of what the actual costs are, the telephone company will provide the public utility commission or whomever a tremendous amount of data, almost enough data that it chokes them, that they can't get through it all.

One of the big problems we have in the State of Washington is because of the massive number of telephone issues and rate filings and all that are going through our utilities transportation commission, the staff has admitted that they have not had an opportunity to do the necessary research they need to do and to verify the cost data that they are getting in order to make adequate recommendations to the commission.

So the data, if, in fact, the information is in there, is very hard to get and because of the volume of information you get, it is very hard to weed it out.

Mr. **Wyden**. Other comments?

Mr. **Bernau**. Mr. Chairman, when PNB made its request on mandatory local measured billing, in Oregon the PUC pointed out that the PNB didn't even know how many lines it had out there to hunt, for example. It was very basic pieces of information that weren't available either to the company or to the PUC, so it seems that a great deal more investigation has to be done by the company and the PUC.

The other point is that the information that we got as members of the public, this is the first time I was ever involved in a ratemaking matter and I can tell you I had to hire a consultant who had left the PNB and was working as a consultant to help me interpret the information that they had submitted to the public utility commission.

I am paid to represent our members—if I couldn't figure it out, certainly they couldn't and this was one big drawback. The material they submitted and the PUC order itself, once the measured service order went into effect, it was 30 to 50 pages in length and it wasn't organized in a way in which the public could understand it.

The public utility commission staff told me that they feel pretty much helpless because they are dependent upon the information that the regulated price to the regulator and whenever we submitted to a proposal to the PUC saying what about this, maybe if we capped the rates in this way, they would say we can't give you an answer, we will have to go to PNB and ask them to plug this in and see if it will work out.

The PUC was entirely dependent upon PNB to generate the data to give us the alternatives that we wanted.

Mr. Dodson. As somebody who has been in a lot of regulatory proceedings before, I can say that the proceedings that Mr. Berneau talked about were unique, both the 1983 and 1984 measured service proceedings, because it was difficult for people to know what the ground rules were.

I think the one lesson that we carried out of both proceedings was the necessity of independently verifiable cost studies, which simply were not available. Even though we hired outside consultants, it was very difficult for the outside consultants to get the raw data base to work from, and immediately after the commissioner entered his order of July of this year, I know that Mr. Morrison contacted Pacific Northwest Bell and asked for the kinds of studies that can be independently verified, and that is the kind of study that we need to develop, the kind of credible rates that I was talking about in my testimony.

Mr. Wyden. All of you gave excellent testimony. I think my colleague, Al Swift, said it very well. This is an extraordinarily complicated problem. The more I investigate it, the more I feel like it is an onion, you peel the layers off and there are always more layers.

Clearly, we want to keep universal service, to keep quality communications systems in business, phone companies have to make a profit, we know that. It is a question of striking a balance, and that is why the question of costs, I think, is so important.

I think if we can figure a way to get the costs on the table so everybody knows what we are talking about, I think people of good faith and reasonableness are going to come to decisions that reflect that balance. I am talking about keeping a universal service system, trying to keep rates affordable, and also insuring that our companies can make a profit.

That is the desire of the three of us on the task force, the illusive balance that we are going to look for. I think you have all been excellent witnesses. I yield to my colleagues.

Al Swift.

Mr. Swift. Thank you very much, Mr. Chairman.

I gather from what you are telling me that there is a lot more awareness of this issue now than there was a year ago, is that correct?

Mr. Bernau. Absolutely.

Mr. Swift. I believe you mentioned that you weren't sure that material sent to some of the charitable organizations was read or, if read, was understood. I can understand that. Are they more interested now in wading through that information to find out what it will do?

Mr. Terry. Yes, they are.

Mr. Swift. I think that is terribly important because in my judgment we missed our best shot at resolving the problem when legislature was tabled in the Senate. We will get another shot. It is a second-best shot, not our first-best shot.

The reason for that is that the outgrowth of divestiture and the introduction of competition, which had nothing to do with divestiture, was done over a decade ago. Those issues are a driving force requiring some change. We are not going to be able to go back and undo anything without incredible disarray in the industry. So time is growing very short to do anything.

We found that one of the toughest things for a public official and a legislative body to do is to try to solve a problem before the public has perceived it. We were fighting the largest corporation in the world. It had the most outstanding public relations effort I have ever seen, presenting their view. But the opposing points of view did not get out. To go to a colleague on a different committee who hasn't been following this and invite him to come into the thicket with you, the response was a lot of very wide eyes saying, "You want me to take on AT&T and my local telephone people on something I don't understand—why"?

Well, we told them that, when the public finds out, they are going to be upset with you and were able to play on it. I would rather have been able to sell those votes on the merits than on the politics, but the politics was all we had to go with since the support wasn't there at the local level from senior citizens, from charities, and we had variable support from small business organizations.

If we take it on again, and I hope we do, I know that Ron, Ike and I will be in the forefront of trying to get this taken out. It will be essential to have support of all your organizations or we won't stand a chance.

The second point I would like to mention, the bypass issue, which I think you have articulated very, very well, is an important issue, I don't for a moment suggest it should be ignored or abandoned or belittled. But it can become a bugaboo in the hands of people that want to achieve certain things. It can be like the ghost in a haunted house that leaps out from behind the wall.

There are a lot of reasons people bypass and some have nothing to do with price. They want certain kinds of very uniquely designed telecommunications service. Some of them do have to do with price, and there are plenty of price signals now. Yet bypass is not rampant at the present time. So, that as we try to work out a problem on access charges, we should not accept uncritically the idea that there is no way around the bypass problem so we have to go with the FCC proposal is wrong.

In our legislation we dealt with the bypass problem in a different fashion. Some said it won't work, essentially saying the FCC had done other things to end the access charge decision. Without getting into SLU and all that, I don't think we should assume because the bypass problem is real, that it is an insoluble. Because if you buy that, you almost are locked into the access charge approach, and I have no question for that.

I am preaching a little bit I guess. This is the last question, and then I will go to Ike. What is your understanding of universal service? I think we have a bait and switch going. Everybody is for universal service, but I find the definition of it changes remarkably. It is a slippery term. I would like to go down the line and see how you define "universal service." What is it you want us to preserve? We will start with you.

Mr. BERNAU. Our members in Oregon view the telephone service as a basic tool of commerce. Now 60 years ago, the Congress and the Public Utility Commission in Oregon said "These are the ground rules. This is how you will operate business," and we did and built businesses and created jobs based upon that tool of communication. And now we have a whole host of interlocking industries based upon that, and all of a sudden, based upon that principle of universal service, the whole issue is now being challenged and we are told to quickly adopt and change to a new way of pricing, which we feel moves away from universal service.

I guess that is the best way I can characterize it.

Mr. SWIFT. Anybody else want to take a whack at it?

The way I would answer that is, I think we have developed a system based on the theory that everyone's telephone is more valuable if it is connected to virtually everyone else's. Are there some subsidies flowing back and forth? Yes. Are those subsidies, like welfare, simply something that you do to help somebody else because they are less fortunate than you? No. Universal service has benefited everybody because the phone instrument itself is more useful to the individual and the small business person, to the large business person for that matter, the more people it is connected to.

Now, some of the ways the term gets used in recent months really amount more to establishing a "phone stamp" program, some form of welfare system, probably ultimately means tested. You can make a good case for a means test. I know a woman in Washington, DC, who got that very low rate where if you don't use the phone much, it is two bucks a month, designed to help the poor. Well, she was an attorney, in fact, was a FCC Commissioner. She got the service because she didn't use her phone much, she was hardly ever there.

She pointed out to me the irony that she, among those least needing a low rate in Washington, was of a lifestyle that could most utilize it, whereas someone who is poor that is at home, elderly or with a large family would be crimped in their use of the telephone if they took advantage of that.

If we change from a system that has worked extraordinarily well, we are going to move into new systems that bring with them all the problems that welfare systems have in them, and there is a serious question of public policy of whether we want to get into that.

I thank you for your testimony.

Mr. **Wyden**. Thank you, Mr. Swift.

Mr. Skelton.

Mr. **Skelton**. Thank you, Mr. Chairman.

I think, from your testimony, we can all conclude that there is a serious problem. We can conclude that what has been done thus far is incredibly unfair or incredibly inequitable.

The question is where do we go from here? Were this a simple matter of dealing with costs of services or costs of producing products for sale, we could probably come up with some reasonable or rational answer as to what people should pay for it on an equitable or fair basis.

As has been pointed out, we are dealing with a subject that is complex, and the costs are terribly uncertain. I am not sure that anyone in this room with any type of accuracy can tell us or say what is the total cost, of providing a type of telephone service, and break it down, whether it be local, multiline, long-distance—I understand that, of course, the utilities, themselves, as has already been pointed out, will come forth with items.

Mr. Bernau, I believe you talked about hunting and the cost of hunting. I might say, before we got involved with this issue, we thought hunting was part of a word like "turkey hunting," but now we know it is something different, where there is an electronic search for a line and when the magic moment comes, there is a connection, and the cost of that is something.

Were you able, for instance, to illustrate the problem, were you able in your research to come forth with any type of cost for the hunting procedure and break it down in any manner whatsoever?

Mr. **Bernau**. Congressman Skelton, the only thing we were able to do was rely upon Pacific Northwest's data, and they weigh their hunting costs average around 90 cents. So we relied on their data to disprove a point. They asked for $14 a month.

Mr. **Skelton**. They came down to $10?

Mr. **Bernau**. Mark Dodson retained experts through his group, and I believe they developed a methodology to help determine the cost.

Mr. **Skelton**. I am using the hunting as a "for instance" because there are many items in this issue that there should be allocation of cost where there is a real cost somewhere along the line. Let's pick on hunting now. What does the hunting process cost?

Mr. **Dodson**. Dr. Thomas Zepp—I have submitted his testimony for the record—of the Zinder Cos. sat down with the Pacific Northwest Bell experts commencing in February of 1984, and examined a lot of their cost studies and their own methodology. I think there was a consensus between our expert and the phone company experts that some of the lines were approximately 12 cents per line per month. Subject to check, I think these were only 10 percent of the lines. The rest of the lines were more, but all of the lines would be under $1.

Mr. SKELTON. So their figure was probably in the ball park?

Mr. DODSON. That is correct. That is when we began to find out that what we have always referred to as cost-based pricing really is a cost-related pricing and if it is $1, as related to $14 or $10 or $7, the three respective rates that we talked about for hunting, that is a very distant relation under anybody's definition.

Mr. SKELTON. Well, your comments on just this isolated issue of hunting tell us we have a complex and difficult problem to learn what the costs are.

Now, with all of this in mind, the difficulty of understanding the costs, and I think we all will agree on that, and were each of you to do it or have experts do it, we might come up with different costs for different things, I think we can agree on that. But the bottom line is this, if you had the magic wand to have an end product piece of legislation leave Congress successfully and go to the President for his signature, what would your proposal be, in as simple terms as you can make them from what you know now?

If you don't know enough now, I would like to know if that is true, and what you would need to know to answer the question. That is the $64 question: What do you propose, and I will ask you, Mr. Smith, first.

Mr. SMITH. That is a very difficult question.

Mr. SKELTON. That is what we are here to find out.

Mr. SMITH. I understand that.

Mr. SKELTON. You know, we have to come up with something, and we are asking you, sir, to help us come up with that something.

Mr. SMITH. First off, I think you have to look at the access charge issue on an interstate basis, and I think you have to look at ability to pay for all classes of customers. Currently, there is an exemption for single-line businesses, residential customers, regardless of ability to pay. I don't know that that is the right answer.

I think that seriously needs to be looked at. I think that there needs to be some very, very strong guidance to the FCC relative to the issues of their tariff work on interstate rates to make sure that, in fact, they are getting effective cost data that can be verified on which to accept or deny particular rate filings.

I think those are two major areas that need to be addressed.

Mr. SKELTON. And would you have any thoughts or comments regarding bypass? Would you have additional thoughts on that?

Mr. SMITH. I think that has to be integral in the overall consideration of access charges, that maybe you charge somebody that does bypass the public network. That is a possibility.

Mr. SKELTON. Because if you have them leaving by reason of bypass, you have fewer people paying this same amount, which means higher figures?

Mr. SMITH. Exactly.

Mr. SKELTON. So this is part of your equation?

Mr. SMITH. Very much so, because small businesses, a term called adverse selection, it is something that small businesses experience in a lot of things. Insurance is a typical example. They are the ones left with the bad risks, and they have to pay higher insurance rates because they are small. We are stuck in the same situation again, we are small, we can't afford to bypass, so we are stuck in the situation of taking what is available, and that is a situation that we don't cherish and want to avoid at all costs.

Mr. SKELTON. The magic wand goes to you.

Mr. BERNAU. I think that the FCC should be required, just as State legislatures should require the public utility commission in their respective States on any regulatory matter that they evaluate the impact of their actions on various parties, not just the Government agencies themselves, but on these that they regulate, small businesses and including the telephone companies that they regulate.

In other words, we need to have a better evaluation by Government agencies of their actions and their impacts upon us. I think that the PUC and the FCC may have taken a different course of action if they had carefully examined what would happen when they charged small businesses $6 per line per month for businesses with over one line. That would be a starting place. It would start them thinking; that would show them the impact of their decisions.

In the issue of access fees and replacing the subsidies, the long-distance revenue provided to local telephone companies, first I would ask for fairness. Why is only one segment of the telephone users singled out to pay this cost?

Last, what the public needs, and businesses, is a basic framework under which all can operate. We need an information system or accounting system wherein telephone ratemaking, where all of us can understand and at least come to some general agreement on what to disagree about. There seems to be little or no information available to evaluate their rate proposals.

I bring back my point on the 1911 railroad accounting system, and my gosh, if you could just change that, that would help us a great deal.

Mr. DODSON. I think Mr. Bernau summarized it very adequately, but let me give one illustration quickly. The Washington Legislature sponsored a symposium just a month ago where a number of leading experts in the Nation came to discuss an awful lot of the telephone costs. It was startling that there wasn't a consensus among that group at all as to which way the subsidies ran, if there were subsidies. It was clear that they were not in a position to devise an overall pricing structure that is going to satisfy everybody, but we will get there.

And once there, there are social decisions that will have to be made within the perimeters of the cost tax, but it is going to take us a while to get there, and take funding.

Mr. TERRY. Because of the complexity of the measured service, charitable organizations like mine, don't have the finance to hire expertise to study the situation. I more or less have to depend on these gentlemen sitting on either side of me to provide the funding and the expertise and the studies to find out whether or not measured service is reasonable.

I could only hope there would be a long-term measured service study before and if that comes into effect.

Ms. **McCleary**. I will confirm what was said before. I don't think that a policy of universal service—94 percent of the households in this country currently can afford to have a telephone. That is a rough standard for universal service. It is accessible, affordable phone service, and I don't believe it is a charity or a welfare statement that it is to everyone's benefit to have people on the phone system. It unites our country. We live in a society that is incredibly mobile, and it is one of the few things that unites us as a group.

I think legislation would confirm the value of universal service to the country, determine a means to avoid bypass, things like charging people who leave the system or requiring that the competitive long-distance service, MCI and SPRINT, pay higher access charges. They get into the system too at a very low rate. In other words, to keep all long-distance down.

Mr. **Wyden**. They may want to talk to you on that point.

Ms. **McCleary**. They may kill me.

The third thing is I think public input. You said it very well. It is a lazy thing, but for 100 years we have not had to think about telecommunications. Ma Bell is the perfect name. We had a mother who took care of everything. All of a sudden we have to.

As an organization in this State, we proposed to the State legislature requiring that the telephone companies submit on a yearly basis 20-year plans. These 20-year plans could change every year, but on a yearly basis, they forecast what they wanted in the next 20 years. The purpose of that would be to allow the public enough catchup time to educate themselves on something like an access charge.

A year ago, who knew what an access charge was, bypass, which is just competition, which is supposedly what we want? That would be the kind of legislation I would want to have.

Mr. **Skelton**. Mr. Lindstrom?

Mr. **Lindstrom**. I think a system that relies on accurate costs that are input, I believe that I would like to, as an individual homeowner having a telephone as well as a businessman that owns more than one phone, I would like to pay my fair share, and fair share includes situations that there has to be a telephone for every home. I think that is essential, and I feel that we, as an individual and as a business, must correct some of these things.

But it should be on a fair, equitable—it should be realizing that the companies that are involved have a fair return on investment. I don't envy you in your task sitting here this morning. Probably the most interesting thing is that as a small businessman, we have been through so rough times. I feel we are coming out of that.

In your situation, I think that you are still trying to resolve this issue. It is going to be a real bucket of worms, and I don't envy you at all.

One thought that comes to mind, as I am being introduced to certain things this morning and being educated also, and I thank you, as I hear the word "bypass" and the implications, isn't there a parallel between big business who have become automated and have withdrawn from the Social Security system, their participation? They no longer have workers.

Mr. **Wyden**. I think it is worth noting right there that we barred that in the last Social Security bill. That is not possible.

Mr. **Lindstrom**. Good.

If that is the case, that is comforting on my part.

Mr. **Skelton**. I thank you all very much.

Mr. **Wyden**. I want to pick up on something you said, Gary. Bypass is a very real concern. There was just an article in Business Week talking about bypass. Nobody questions that this is a very real concern. There is, I think, a substantial debate about why bypass is occurring. The most substantive study done, as far as I know, is one by Southwestern Bell, which indicates that people don't principally bypass because of cost, cost is a factor, but the primary reason is service and quality.

Our largest corporation, Tektronics, has already said, for the record, the primary reason that they bypass is related to service, not because of cost. But the Congress is very concerned about this problem.

For example, the legislation that the House passed, H.R. 4102, would have cut by about 50 percent the amount that long-distance tolls return back to local service because of the fact that we all believed too much had gone back, and in years past that 50 percent figure was the figure targeted as being what was needed to substantially reduce the bypass threat.

I remember talking about how I thought we ought to cut it 50 percent, everybody in the telephone companies would clap like crazy, and it wasn't until the FCC came along and said "You won't have to pay a long-distance company for nontraffic sensitive costs that we weren't so popular on that point any longer."

But I think we have to look carefully at bypass, because if we don't handle this right, we are going to lock ourselves into the access charge situation forever, and then we still have the prospect that a lot of the small businesses in this country will pay more in access charges than they pay in the long-distance bills.

The other thing that concerns me so much is that if we drop everything we are doing and really just focus on the big users, which is what the bypass issue is about, I feel we will be going toward what I call supply side telephone serivce, which is to gear everything to the largest people based on the premise that without somehow favoring them, they are all going to leave us, so favor them and let them create this revenue base and presumably something is going to trickle down to insurance agents, gas stations, grocery stores, and the like. I would just submit that this country has not always had good success with these supply sided adventures. And I would hope that we would just proceed in this area cautiously.

Mr. **Smith**. If I can respond.

Mr. **Wyden**. Please.

Mr. **Smith**. The issue of bypass, again, is a question, do we design a whole system to avoid all bypass or what degree of bypass is acceptable and what is the cost of that degree of bypass? The primary concern that maybe I didn't express today well enough is that you have a system right now where residential customers and single-line business customers, regardless of their ability to pay, have been exempted from the access charge situation.

A small business is not a small business with only one telephone line. Most of our members have more than one telephone line. What is the resulting impact is that those small businesses with more than one telephone line are paying the access charge plus they are paying higher than would be long-distance rates because the residents and single-line businesses are not paying a consumer access line charge.

Mr. SWIFT. Lower long-distance rates than you have currently and bypass—what you are saying is that those rates will not be as low as they might otherwise be, but the trend is down from what they are now.

Mr. SMITH. I agree. We have to look at the long-term situation and determine the degree of bypass. I think we are all talking the same direction, but right now small business is caught in a difficult spot.

Mr. WYDEN. We thank you all and are looking forward to working with you in the days ahead.

Mr. Eugene Pfeifer, vice president for consumer affairs and information, Pacific Northwest Bell/USWEST; Darryl Branstetter, division staff manager, marketing, Pacific Telesis Inc.; Perry Swisher, Commissioner, Idaho Public Utility Commission; and Bridger M. Mitchell, senior economist, The Rand Corp.

Why don't we just go ahead. Mr. Pfeifer, we are very pleased to have you come. The name of Pacific Northwest Bell has come up once or twice this morning. We will make your testimony a part of the record. Feel free to make any comments that you would like.

TESTIMONY OF EUGENE L. PFEIFER, VICE PRESIDENT OF EXTERNAL AFFAIRS, PACIFIC NORTHWEST BELL TELEPHONE CO.

Mr. PFEIFER. I am Eugene Pfeifer, vice president-external affairs for Pacific Northwest Bell Telephone Co. My office is located at 1600 Seventh Avenue, here in Seattle.

I would like to thank you and other members of the committee for inviting me to testify. There is a great deal of misinformation circulating about telephone costs and telephone prices and to the extent that congressional leaders, such as yourselves, have accurate and correct information, the better able you will be to understand and support the evolving telecommunications market. I have included answers to your questions in exhibit 1 and intend to limit this statement to a discussion of the need for cost-based pricing.

I would like to begin by documenting the fact that the concept of universal service originated not in Congress but with the employees and leaders of the early Bell System. Long before Congress passed the Communications Act, Bell managers had set universal service as a goal: "That the system be complete and of the greatest utility, it is necessary that as many persons as possible should be connected to it * * *." (AT&T Annual Report, 1901.)

Few would disagree that the telephone is now ubiquitous and that a great deal of credit for this achievement belongs to telephone company employees.

Although the "One Bell System" no longer exists, it is ludicrous to think that any of the Bell Companies intend to dump the achievement they have worked for literally their entire corporate lives.

And yet there are some who have suggested that we are contributing to the downfall of universal service because we support an end user charge plan.

The fact is that Congress has had many opportunities to take action which would have preserved the Bell System and its practice of providing toll subsidies to end users. Exhibit 2 is a chronology of the events which have led us to the situation we are in today. You will note that as far back as 1976, Congress was told what impact competition would have on end users. Now, when it is too late, you hold hearings to investigate those impacts, and you are suddenly interested in universal service.

I submit that the cause of universal service and the welfare of telephone users will be better served by the local telephone companies and their regulators than by the legislators who are wrestling with an increase in the national debt of $172 billion. Quite frankly, given Congress' track record of overall spending, I am alarmed that we now propose to come up with rate and service plans that "add up."

Congress has had direct opportunities to lower end user phone bills by allowing the Federal excise tax on telephone service to expire. With a few years exception, this tax has been applied since 1949, and it has always been designated as "temporary." For years politicians have been promising to remove it. I remember the Excise Tax Reduction Act of 1965. It provided for final termination of the tax in 1969. Fifteen years later, we are still awaiting a "final termination" date. The tax now stands at 3 percent, up from 2 percent in 1980, and is applied to virtually every component of telephone service: long-distance calls, local access service, terminal equipment.

I note that you, Congressman Wyden, voted to extend the excise tax on telephone service, despite the fact that it is levied on the poor, the elderly, and the small business customer. Perhaps you are not aware of the fact that this tax adds about $1.40 a month to an average residence bill and almost $8 a month to a small, five-line business bill.

In contrast, PNB has always stated that as the nontraffic sensitive costs of access are moved off the traffic sensitive rates, we would be able to lower long-distance rates. We kept our word when, in January, we implemented a temporary access line charge of $1.39 in Washington and lowered our intrastate rates by almost 5 percent.

We at PNB are also proud of our success at keeping rates low. Since 1960, the cost of our local and long-distance service has increased by only 71 percent. Compare that to the national increase of 352 percent for medical care, a 231 percent increase in the price of food, and 258 percent in the price of housing.

With skyrocketing increases in such basic necessities as food and shelter and with a national debt problem that does nothing but get bigger and threaten the economic well-being of the entire Nation, I find it flattering that U.S. Representatives would devote time and attention to proposed monthly increases of $2 and $6.

To illustrate PNB's effectiveness at keeping rates low, consider that if PNB rates had simply kept pace with inflation over the past 23 years, residence customers would be paying about $22 for premium flat rate service and business customers about $63. These prices are $6 to $26 more than what our subscribers currently pay.

Looking at telephone rates in relation to average hourly earnings, in 1965, it took an Oregon manufacturing employee 2.1 hours of work each month to pay for premium flat rate service. Today it takes that same worker only 1.5 hours. Contrast that to recent statistics which demonstrate that if you work an 8-hour day, you spend almost 1¾ hours each day working to pay Federal taxes.

A great deal has been said about citizens on a fixed income. In fact, because Social Security benefits have been indexed to the cost of living, retired workers use a lower percent of their benefits for phone service now than in 1960.

For example, a single retiree in Seattle used 7.2 percent of her 1960 benefits to pay for premium flat rate residence service. At the end of 1983, only 3.1 percent of those benefits was required to pay for telephone service. This percent would fall to 1.2 percent if the retiree selected our lowest price-measured service.

The point I am making is that by any factual standard, telephone service has been, and is today, very reasonably priced. However, cross-subsidies abound in the pricing structure, and not all services, cover their direct costs. Let me give you some examples of the cross-subsidies that exist:

First, many business access rates are above incremental cost. All resident access rates are below cost by a range of about 55 to 75 percent.

Second, toll rates are significantly above cost.

Third, on a monthly basis, we estimate that over 50 percent of the calls to Directory Assistance are made by only 4 percent of the customers.

Fourth, in the business environment, heavy users cost us more than light users. Light business users subsidize heavy business users.

Fifth, by and large, providing service to urban areas, where many low-income citizens reside, costs us less than service to rural customers, but urban customers pay more.

If PNB had a monopoly on all telephone service today, many inequities in our pricing structures could be continued. However, the reality is that advances in telecommunications technology have brought competition to the marketplace and competition drives prices to cost.

This reality is the moving force behind the FCC's access charge plan. The plan gradually moves the allocation of nontraffic sensitive costs from traffic sensitive long-distance rates to the nontraffic sensitive access line rates where it belongs.

I have heard arguments which say that long-distance companies should pay for local plant costs. Without getting technical, I want to emphasize that the FCC's plan requires them to do just that. They are charged for use of the local loop, that is, the wires and equipment that connect the house or building to the telephone company's central office.

They are also charged for use of the equipment that connects the central office to their switching equipment. Under the original FCC plan, the carrier charges for use of the local loop were to be phased down, but not entirely eliminated, as the end user charges were phased up.

This is a reasonable, economically sound way to cover the cost of those telephone wires. PNB would not spend money to install and maintain an access line unless an end user requests service. It is, therefore, the end user, not the long-distance companies, who causes the costs of access, and it is the end user who should pay the majority of those costs.

Your assertion that long-distance companies should subsidize a major portion of the access line is like asking the various networks, ABC, NBC, Turner Broadcasting, CBS, PBS, ESPN, et cetera, to pay for a portion of a customer's cable link or antenna. The logic is the same, that if the customer's cable or antenna wasn't there, the networks would have to build a link to reach that customer's home.

The fallacy is obvious: If an individual wants access to the world of television, it is up to that individual, not the networks, to bear the economic cost of that access in the form of purchasing or leasing a set and providing the means of receiving the signals. A cable customer, thus, pays a monthly fee for access whether the TV is turned on or not. In like manner, individuals who choose to have access to the world of telecommunications are responsible for the economic cost of that decision.

I reiterate, PNB is not turning its back on universal service. We have achieved a subscription rate of close to 95 percent in our serving area, and we do not intend to let that achievement slip. What I am saying is that as a matter of public policy, it is fair that consumers bear the economic costs of their choices.

The other important matter of policy is that as a nation, we have agreed to help the needy, either through Government subsidies or through private donations. In the area of telephone service for the needy, a program like Washington Natural Gas Co.'s Warm Neighbor Program or a targeted subsidy in the form of telephone stamps may someday be desirable. But if we are to retain a subsidy for basic service, it has to become targeted to those who really need it.

The charge that large numbers of residential customers are leaving the network because they cannot afford the monthly charge for basic service is absolutely false. Results of the Washington Utilities and Transportation Commission study of residential disconnects through June 1984 indicate that less than 1 percent of the disconnectees say they are leaving because they can't afford the service, and this group's average final bill is 20–40 percent toll.

The fact is that the per-day charge for residential budget service is less than the cost of a first-class postage stamp. This option provides the customer with the same single party, high quality line as customers on premium flat rate. The difference is that each completed outgoing local call is charged using the local usage rates. With customer options like this, the alarmist rhetoric calling for protection of universal service is patently ludicrous.

A discussion of cost-based pricing would not be complete without a discussion of fully measured business service, which is a pricing system that is cost based and truly reflective of how telephone costs are incurred. As I mentioned, measured service has two components: a fixed monthly charge for access to the network and a charge for each outgoing local call. The access charge is flat rated because the cost to provide access is the same regardless of the volume of calls made. Each local outgoing call is charged for on a usage basis because each time a call is made, costs in the form of trunks, switches, et cetera, are incurred.

This pricing system does not differ in principle from that used by other utilities and by business in general. It charges customers only for the amount they use and allows them to control costs by means of conservation.

The plan benefits Pacific Northwest Bell because it lets customers know that local usage is not a free commodity, thus encouraging economic efficiency in the use of the local network. It also allows us to equitably recover the costs we incur to accommodate increased usage. Another important benefit is that measured service allows us to recover revenue in shared line or resale situations.

PNB filed for a fully measured business pricing plan in Oregon in July 1983, and we began meeting with Oregon business customers, large and small, to discuss this pricing plan in late 1982. I won't go into a long account of the filing's disposition; suffice it to say that both Commissioner Lobdell and his successor, Commissioner Maudlin, approved the plan as being "reasonable and justifiable." The OPUC staff conducted independent cost studies and analyses and likewise supported the concept.

I agree with comments Representative Wyden has made that fully measured business service is a big change in the way telephone service is priced. I also agree that the bills of some users—like sales solicitors and firms utilizing computer-originated calls—would have increased significantly. However, if your State or community had a grocery pricing plan that charged every citizen the exact same amount as everyone else, regardless of the quality or quantity of food they took home, would you object to a move to charge based on what each individual selects? Would you support a situation in which every individual paid the same annual flat rate tax, regardless of income? If you would and if you view these as reasonable pricing/taxing plans, then I can understand why we have a gross national debt closing in on $2 trillion.

With your focus on small businesses and State economies, I hope you will consider and focus on this one fact: Maintaining a flat rate pricing plan for telephone service to attract businesses to your State is fine and well, as long as those new businesses are not heavy local usage firms. For if they are, and the telephone companies have to add plant to accommodate their increased usage, the bill for that will be divided evenly among all users. It is kind of like going to dinner with a large group and ordering a modest meal, only to have the bill divided evenly at the end. You end up having to subsidize someone's lobster and chocolate souffle.

Rate structures are basically nothing more than an attempt to split the bill. My view is that a plan which asks customers to pay for what they eat is reasonable and equitable. Congressman Wyden's view is that the measured business plan is a headache. I guess a lot of where you come out on this has to do with whether you ate lobster or chicken.

In closing I would like to read some remarks made by Alfred E. Kahn, who is currently the Robert Julius Thorne professor of economics at Cornell University and former chairman of the New York Public Utilities Commission:

> Competition complicates all our lives, but its beauty is that it forces us to comply with the dictates of economic realities and its consolation is that to the extent we do, there will be improved welfare for most of us and efficient ways of taking care of the ones who fall behind and genuinely deserve help.

Gentlemen, by its failure to support a monopoly telephone system, Congress has allowed competition to become the economic basis of this Nation's telecommunications system. I recognize that it is now very easy to stand against the pricing changes that competition mandates, but I urge you to resist making belated, shortsighted bids to turn back the clock.

[Mr. Pfeifer's prepared statement with attachments follows:]

PREPARED STATEMENT OF EUGENE L. PFEIFER, VICE PRESIDENT OF EXTERNAL AFFAIRS, PACIFIC NORTHWEST BELL TELEPHONE CO.

My name is Eugene Pfeifer and I am the Vice President - External Affairs for Pacific Northwest Bell Telephone Company. My office is located at 1600-7th Avenue here in Seattle.

I'd like to thank Congressman Wyden and the other members of this committee for inviting me to testify. There is a great deal of misinformation circulating about telephone costs and telephone prices and to the extent that Congressional leaders such as yourselves have accurate and correct information, the better able you'll be to understand and support the evolving telecommunications market. I have included answers to your questions in Exhibit 1 and intend to limit this statement to a discussion of the need for cost-based pricing.

I'd like to begin by documenting the fact that the concept of universal service originated not in Congress but with the employees and leaders of the early Bell ~~Company~~ System. Long before Congress passed the Communications Act, Bell managers had set universal service as a goal:

> "That the system be complete and of the greatest utility, it is necessary that as many persons as possible should be connected to it ..."
>
> AT&T Annual Report - 1901

Few would disagree that the telephone is now ubiquitous and that a great deal of credit for this achievement belongs to telephone company employees.

Although the "One Bell System" no longer exists, it is ludicrous to think that any of the Bell Companies intend to dump the achievement they have worked for literally their entire corporate lives.

And yet there are some who have suggested that we are contributing to the downfall of universal service because we support an end user charge plan.

The fact is that Congress has had many opportunities to take action which would have preserved the Bell System and its practice of providing toll subsidies to end users. Exhibit 2 is a chronology of the events which have led us to the situation we're in today. You'll note that as far back as 1976, Congress was told what impact competition would have on end users. Now, when it's too late, you hold hearings to investigate those impacts and you're suddenly interested in universal service.

I submit that the cause of universal service and the welfare of telephone users will be better served by the local telephone companies and their regulators than by the legislators who are wrestling with an increase in the national debt of $172 billion. Quite frankly, given Congress' track record of overspending, I am somewhat alarmed that Chairman Wyden we now propose~~s~~ to come up with rate and service plans that "add up."

Congress has had direct opportunities to lower end user phone bills by allowing the federal excise tax on telephone service to expire. With a few years exception, this tax has been applied since 1914 -- and it's always been designated as "temporary." years - Politicians have been promising for years to remove it. I remember the Excise Tax Reduction act of 1965 -- it provided for "final termination" of the tax in 1969. Fifteen years later, we are still awaiting a "final termination" date. The tax now stands at 3% -- up from 2% in 1980 -- and is applied to virtually every component of telephone service: long distance calls, local access service, terminal equipment.

I note that you, Congressman Wyden, voted to extend the excise tax on telephone service, despite the fact that it is levied on the poor, the elderly, and the small business customer. Perhaps you are not aware of the fact that this tax adds about $1.40 per month to an average residence bill and almost $8.00 a month to a small, five line business bill.

In contrast, PNB has always stated that as the non-traffic sensitive costs of access are moved off the traffic sensitive rates, we would be able to lower long distance rates. We kept our word when, in January, we implemented a temporary access line charge of $1.39 in Washington and lowered our intrastate rates by almost 5%.

We at PNB are also proud of our success at keeping rates low. Since 1960, the cost of our local and long distance service has increased by only 71%. Compare that to the national increase of 352% for medical care, a 231% increase in the price of food, and a 258% increase in the price of housing.

With skyrocketing increases in such basic necessities as food and shelter and with a national debt problem that does nothing but get bigger and threaten the economic well-being of the entire nation, I find it flattering that U.S. Representatives would devote time and attention to proposed monthly increases of two and six dollars.

To illustrate PNB's effectiveness at keeping rates low, consider that if PNB rates had simply kept pace with inflation over the past 23 years, residence customers would be paying about $22 for premium flat rate service and business customers about $63. These prices are $6 to $26 more than what our subscribers currently pay.

Looking at telephone rates in relation to average hourly earnings, in 1965 it took an Oregon manufacturing employee 2.1 hours of work each month to pay for premium flat rate service. Today, it takes that same worker only 1.5 hours. Contrast that to recent statistics which demonstrate that if you work an eight-hour day, you spend almost one and three quarters hours each day working to pay federal taxes.

A great deal has been said about citizens on a fixed income. In fact, because Social Security benefits have been indexed to the cost of living, retired workers use a lower percent of their benefits for phone service now than in 1960. For example, a single retiree in Seattle used 7.2% of her 1960 benefits to pay for premium flat rate residence service. At the end of 1983, only 3.1% of those benefits was required to pay for telephone service. This percent would fall to 1.2% if the retiree selected our lowest price measured service. (See Exhibit 3.)

The point I am making is that by any factual standard, telephone service has been -- and is today -- very reasonably priced. However, cross-subsidies abound in the pricing structure, and not all services cover their direct costs. Let me give you some examples of the cross-subsidies that exist:

1. Many business access rates are above incremental cost. All residence access rates are below cost by a range of about 55% to 75%.

2. Toll rates are significantly above cost.

3. On a monthly basis, we estimate that over 50% of the calls to Directory Assistance are made by only 4% of the customers.

4. In the business environment, heavy users cost us more than light users. Light business users subsidize heavy business users.

5. By and large, providing service to urban areas, where many low income citizens reside, costs us less than service to rural customers, but urban customers pay more.

If PNB had a monopoly on all telephone service today, many inequities in our pricing structures could be continued. However, the reality is that advances in telecommunications technology have brought competition to the marketplace and competition drives prices to cost.

This reality is the moving force behind the FCC's access charge plan. The plan gradually moves the allocation of non-traffic sensitive costs from traffic sensitive long distance rates to the non-traffic sensitive access line rates where it belongs.

I have heard arguments which say that long distance companies should pay for local plant costs. Without getting technical, I want to emphasize that the FCC's plan requires them to do just that. They are charged for use of the local loop -- i.e., the wires and equipment that connect the house or building to the telephone company's central office. They are also charged for use of the equipment that connects the central office to their switching equipment. Under the original FCC plan, the carrier charges for use of the local loop were to be phased down, but not entirely eliminated, as the end user charges were phased up.

This is a reasonable, economically sound way to cover the cost of those telephone wires. PNB would not spend money to install and maintain an access line unless an end user requests service. It is therefore the end user, not the long distance companies, who causes the costs of access and it is the end user who should pay the majority of those costs.

~~Congressman Wyden's~~ Your assertion that long distance companies should subsidize a major portion of the access line is like asking the various networks -- ABC, NBC, Turner Broadcasting, CBS, PBS, ESPN, etc. -- to pay for a portion of a customer's cable link or antenna. The logic is the same -- that if the customer's cable or antenna wasn't there, the networks would have to build a link to reach that customer's home.

The fallacy is obvious: if an individual wants access to the world of television, it is up to that individual -- not the networks -- to bear the economic cost of that access in the form of purchasing or leasing a set and providing the means of receiving the signals. A cable customer thus pays a monthly fee for access whether the TV is turned on or not. In like manner, individuals who choose to have access to the world of telecommunications are responsible for the economic cost of that decision.

I reiterate -- PNB is not turning its back on universal service. We have achieved a subscription rate of close to 95% in our serving area and we do not intend to let that achievement slip. What I am saying is that as a matter of public policy, it is fair that consumers bear the economic costs of their choices.

The other important matter of policy is that as a nation, we have agreed to help the needy, either through government subsidies or through private donations. In the area of telephone service for the needy, a program like Washington Natural Gas Company's "Warm Neighbor Program" or a targeted subsidy in the form of "telephone stamps" may someday be desirable. But if we are to retain a subsidy for basic service, it has to become targeted to those who really need it.

The charge that large numbers of residential customers are leaving the network because they cannot afford the monthly charge for basic service is absolutely false. Results of the Washington Utilities and Transportation Commission study of residential disconnects through June of 1984 indicate that less than 1% of the disconnectees say they are leaving because they can't afford the service, and this group's average final bill is 20-40% toll.

The fact is that the per day charge for residential budget service is less than the cost of a first class postage stamp. This option provides the customer with the same single party, high quality line as customers on premium flat rate. The difference is that each completed outgoing local call is charged using the local usage rates. With customer options like this, the alarmist rhetoric calling for protection of universal service is patently ludicrous.

~~A di~~scussion of cost-based pricing would not be complete without a discussion of Fully Measured Business Service, which is a pricing system that is cost-based and truly reflective of how telephone costs are incurred. As I mentioned, measured service has two components: a fixed monthly charge for access to the network and a charge for each outgoing local call. The access charge is flat-rated because the cost to provide access is the same regardless of the volume of calls made. Each local outgoing call is charged for on a usage basis because each time a call is made, costs in the form of trunks, switches, etc., are incurred.

This pricing system does not differ in principle from that used by other utilities and by business in general. It charges customers only for the amount they use and allows them to control costs by means of conservation.

The plan benefits Pacific Northwest Bell because it lets customers know that local usage is not a free commodity, thus encouraging economic efficiency in the use of the local network. It also allows us to equitably recover the costs we incur to accommodate increased usage. Another important benefit is that measured service allows us to recover revenue in shared line or resale situations.

PNB filed for a Fully Measured Business pricing plan in Oregon in July of 1983, and we began meeting with Oregon business customers - large and small - to discuss this pricing plan in late 1982. I won't go into a long account of the filing's disposition; suffice it to say that both Commissioner Lobdell and his successor, Commissioner Maudlin, approved the plan as being "reasonable and justifiable". The OPUC staff conducted independent cost studies and analyses and likewise supported the concept.

I agree with comments Representative Wyden has made that Fully Measured Business service is a big change in the way telephone service is priced. I also agree that the bills of some users -- like sales solicitors and firms utilizing computer-originated calls -- would have increased significantly. However, if your state or community had a grocery pricing plan that charged every citizen the exact same amount as everyone else, regardless of the quality or quantity of food they took home, would you object to a move to charge based on what each individual selects? Would you support a situation in which every individual paid the same annual flat rate tax, regardless of income? If you would and if you view these as reasonable pricing/taxing plans, then I can understand why you would oppose -- or do not support -- a move to fully measured business and I begin to understand why the gross national debt is closing in on $2 trillion dollars.

With your focus on small businesses and state economies, I hope you will consider and focus on this one fact: maintaining a flat rate pricing plan for telephone service to attract businesses to your state is fine and well, as long as those new businesses are not heavy local usage firms. For if they are, and the telephone companies have to add plant to accommodate their increased usage, the bill for that will be divided evenly among all users. It's kind of like going to dinner with a large group and ordering a modest meal, only to have the bill divided evenly at the end. You end up having to subsidize someone's lobster and chocolate souffle.

Rate structures are basically nothing more than an attempt to split the bill. My view is that a plan which asks customers to pay for what they eat is reasonable and equitable. Congressman Wyden's view is that the measured business plan is a "headache." I guess alot of where you come out on this has to do with whether you ate lobster or chicken.

In closing I'd like to read some remarks made by Alfred E. Kahn, who is currently the Robert Julius Thorne Professor of Economics at Cornell University and former chairman of the New York Public Utilities Commission:

> "Competition complicates all our lives, but its beauty is that it forces us to comply with the dictates of economic realities and its consolation is that to the extent we do, there will be improved welfare for most of us and efficient ways of taking care of the ones who fall behind and genuinely deserve help."

Gentlemen, by its failure to support a monopoly telephone system, Congress has allowed competition, to become the economic basis of this nation's telecommunications system. I recognize that it's now very easy to stand against the pricing changes that competition mandates, but I urge you to resist making belated, short-sighted bids to turn back the clock. ②

I assure you that PNB will not allow universal service to diminish in the new environment. I also guarantee that if given the opportunity to fairly compete, PNB will be a leader in providing the improvements, advances, and service that our customers - residence and businesses of all size - have come to expect.

Exhibit 1
Page 1 of 3

Testimony of E. L. Pfeifer
to the
United States House of Representatives
Committee on Small Business
Special Task Force on Telephones

Q. What are the benefits to telephone users, particularly small businesses, and to the telephone companies, of mandatory measured service?

A. 1. Provides the business customer the opportunity to monitor and control local calling and therefore, the costs of local service.

2. As initially filed in Oregon, would have saved many customers money. Measured Service is a fair method of pricing the non-traffic sensitive access line and usage, which is traffic sensitive. When combined with the usage allowance options it allows business customers to tailor their local service to their specific needs.

3. Business customers can tailor their local service to meet their seasonal business shifts by changing allowance options. Of course, there is an automatic reduction in local costs for a business in a slow season as the calling drops.

4. Customers pay their local service in concert with their individual needs and usage and not on some broad average basis as with flat rate.

5. The usage information can be of use in tracking and productivity studies. It provides a source of information relating to their local business activity and employee activity levels.

6. It is a step in the move to cost based pricing which will allow customers to choose alternatives based on accurate economic price signals.

7. Compensates PNB in the growing resale and sharing market.

8. Provides ability to phone companies to stimulate discretionary usage.

9. Helps prepare the local phone company to meet competition by having local rates based more on cost.

10. Based on approved measured rates in Oregon, the price entry for a business customer is cut by a range of 16% to 39% when compared to flat rate. This should allow a new business to enter the market and pay for the calls in relationship to its own business activity and growth.

Exhibit 1
Page 2 of 3

Q. What is the cost per minute of measuring telephone usage?

A. Incremental costs which result from measuring local usage are those associated with additional measuring equipment, comptrollers billing, business office inquiries and calls to operators. The total of these costs are:

	First Min.	Add'l. Min.
PNB Average	$.00478	$.00005

The additional costs associated with measuring will be partially offset by reductions in switching and trunking expenses due to repression which is expected to result from the introduction of a measured service plan.

Q. What is the cost per minute of making a local telephone call in your system?

A. The cost of making a flat rate local call is:

	First Min.	Add'l. Min.
PNB Average	$.03316	$.01323

The cost per minute during the day time period would be higher than this average and the cost during the evening period would be lower.

Q. What are your views on the proposed universal access or end user charges?

A. I think they are an equitable and gradual means of shifting costs to the cost causers. Please see pages 6 and 7 of my statement for further comments.

Q. What percentage drop off of residential users do you anticipate from the imposition of access charges?

A. Local studies seem to indicate that very few residence customers will cancel their service due to higher monthly rates. As I mentioned, less than 1% of those who cancelled service in Washington in the first six months of 1984 did so for the reason, "couldn't afford the service." This sampling included the four months when access line surcharge ($1.39/line/month) approved by the WUTC were in effect.

I'm sure the Task Force members are also familiar with these studies which examine access charges on a broader level:

1. "Impact of the FCC Access Charge Plan on the U.S. Economy," by Wharton Econometric Forecasting Associates, 11/83.

Exhibit 1
Page 3 of 3

2. "Local Telephone Rates: Issues and Alternatives," by the Congressional Budget Office, 1/84.
3. "Residential Demand for Telephone Service," by Lewis J. Perl of National Economic Research Associates (NERA), 12/83.
4. "Are Recent FCC Telephone Rate Reforms A Threat to Universal Service?", by Kenneth Gordon and John Haring, 12/83.

And last, FCC Docket 83-788 (12/83) responds to access inquiries raised by the State of Michigan and the Michigan PSC.

Q. Do you anticipate that businesses will reduce the number of telephone lines they have in response to higher access fees?

A. No. Preliminary PNB figures show very little business customer reaction as a result of the end user charges implemented on May 25.

E.L. Pfeifer Testimony
Exhibit 2

A Brief History of Events Affecting the Telephone Industry

1934 – COMMUNICATIONS ACT OF 1934: U.S. Congress passes the Communications Act of 1934 affirming the goal of universal telephone service. The Act also recognized the telephone industry as a natural monopoly and established the FCC as the national regulatory body for the industry.

1949 – ANTITRUST SUIT: U.S. Department of Justice files antitrust suit against AT&T and Western Electric.

1956 – CONSENT DECREE: AT&T signs Consent Decree settling 1949 antitrust suit. Agreement limits AT&T to providing communication services subject to regulation and manufacture of equipment to provide such services.

1956 – HUSH-A-PHONE: The FCC ruled that harmless devices could be attached to Bell equipment. The Hush-A-Phone was simply a device that attached to the phone mouthpiece and muffled conversations. It did not tie into the network.

1959 – ABOVE 890 DECISION: Competition in the long distance market was born when the FCC opened up a portion of the microwave spectrum above 890 megahertz for use by private microwave systems.

1968 – CARTERFONE: When the FCC ruled that the Carterfone, a two-way radio, could be connected to the network, it paved the way for other suppliers of residential phones, PBXs and other interconnecting devices. A "protective coupler" was required to prevent harm to the network.

1969 – LONG DISTANCE COMPETITION: Permission to build and operate a microwave link between St. Louis and Chicago, in direct competition with AT&T, was granted to MCI, a specialized common carrier.

1971 – SPECIALIZED COMMON CARRIER: Other private specialized common carriers were given permission to operate nationwide and AT&T was instructed to provide local interconnections.

1971 – COMPUTER INQUIRY I: Through a separate subsidiary, telecommunications companies were allowed to provide unregulated computer services. AT&T was denied because of a 1956 Consent Decree restricting it to regulated communications.

1972 – SATELLITE TRANSMISSION: The FCC encouraged competing telecommunications companies to route their circuits through satellites, greatly expanding the effect of the Specialized Common Carrier Decision.

1972 – FCC JURISDICTION: The FCC decided it should have sole jurisdiction in the field of interconnection. That ruling was appealed by the Bell System and others, but was upheld by the Supreme Court in 1976.

1974 – ANTITRUST SUIT: The Department of Justice filed a civil antitrust suit against the Bell System asking for divestiture of Western Electric and Bell Labs.

1975 – REGISTRATION PROGRAM: The FCC allowed some non-Bell equipment to be connected to the network without protective devices, provided it met certain standards and was registered with the FCC.

1976 – REGISTRATION EXPANDED: The registration program was expanded to include virtually all terminal equipment except that used with party line and coin services.

1976 – CONGRESSIONAL ACTION BEGINS: The first bill introduced in Congress that would have reaffirmed intent of Communications Act of 1934. Subsequent bills would rewrite the Act to restructure the industry and allow more competition. (NOTE: Legislation also introduced in 1977, 1978, 1979, 1980, 1981.)

1977 – EXECUNET: MCI and other competitive carriers allowed to provide regular long distance service – not just private line – through their own microwaved networks.

1977 – REGISTRATION REAFFIRMED: Supreme Court refuses to review registration program. Equipment registered with the FCC can be connected directly to the network.

1980 – COMPUTER INQUIRY II: One of the most important rulings in the FCC's history, this action called for the detariffing of terminal equipment. AT&T and others would be allowed to offer unregulated services and equipment through a Fully Separated Subsidiary. Originally scheduled for March 1, 1982, the implementation date was delayed to January 1, 1983.

1981 – CONGRESSIONAL ACTION: Debate continues on efforts to rewrite the Communications Act of 1934: S. 898 and H.R. 5158 introduced.

1982, Jan. – NEW CONSENT DECREE: Justice Department drops antitrust suit against Bell System after AT&T agrees to divest itself of local Bell company operations.

1982, Jan. – COURT REVIEWS CONSENT DECREE: U.S. District Court Judge Harold Greene says he will determine if Consent Decree is in public interest and establishes 60-day public comment period on Decree.

1982, July – LEGISLATION WITHDRAWN: Congressman Wirth withdraws H.R. 5158 from further consideration, dropping the bill.

1982, Aug. – COURT RULES: Judge Greene issues opinion on 1982 Consent Decree calling it "plainly in the public interest," but asks for modifications.

1982, Aug. – NEW CONSENT DECREE APPROVED: Judge Greene approved the agreement between AT&T and Justice Department by signing revised Consent Decree with modifications requested earlier.

1982, Oct. – LATAs: AT&T and Bell operating companies file plans with court defining 161 geographic areas called Local Access Transportation Areas (LATAs) which define areas operating companies will serve following divestiture.

1982, Dec. – AT&T FILES REORGANIZATION PLAN: AT&T files plan of reorganization with the court outlining separation of 22 operating companies.

1982, Dec. – ACCESS CHARGING: FCC, in Docket 78-72, announces long-studied access charging guidelines. Long distance subsidy to local service to be phased out beginning at divestiture, January 1, 1984.

1983 – COMPUTER INQUIRY II EFFECTIVE: American Bell, Inc. sells new and enhanced services; PNB offers equipment from inventory during 1983.

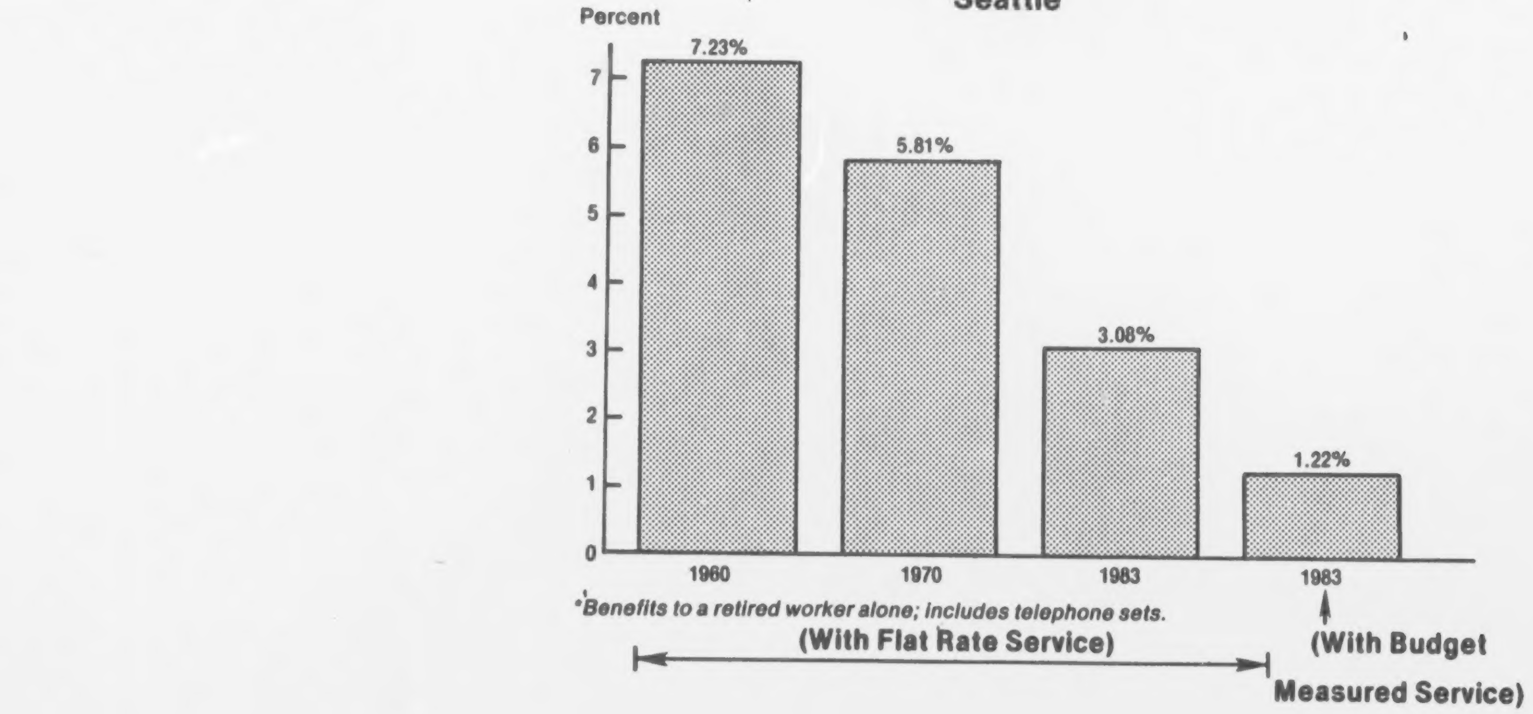
1983 (projected):

- FCC to issue formal order on access charging (Docket 78-72).
- Court decision expected on reorganization plan.
- New regional companies to be incorporated after reorganization plan approved.
- Court decision on LATAs expected.

1984 – DIVESTITURE: Under the reorganization plan, PNB and the 21 other operating companies will be separated from AT&T on January 1, 1984. Operating companies to be formed into seven regional companies.

E.L. Pfeifer Testimony
Exhibit 3

Monthly Residence Telephone Rate As Percent Of Average Monthly Social Security Benefits*
Seattle



*Benefits to a retired worker alone; includes telephone sets.

Mr. **Wyden**. Gene, thank you very much. I am certainly going to have a few questions in a couple of minutes, but Al has to shoot off to another meeting so let us let him ask some questions.

Mr. **Swift**. I apologize to the panel and to my colleagues for having scheduled a noon function elsewhere before this hearing was set.

You certainly understand that the best defense is a good offense. This is as offensive a statement as I have read in a long time.

Mr. **Pfeifer**. I am trying to get it in perspective.

Mr. **Swift**. The irony is I brought these things down here. I don't know how they ended up in my hand. You asked if I had read them and I hadn't, which is probably a good thing or I might have lost them somewhere on I-5.

I think your analogy with television networks is not accurate. I am not sure there is an accurate analogy. I would like to discuss one of my own.

You are suggesting that the television viewer would have to pay for receving network programming if you were to implement the same thing that you have with telephone systems, is that accurate?

Mr. **Pfeifer**. Conceptually. We are talking different timeframes. The telephone system has been built over the last 100 years, cable television in the last 10.

Mr. **Swift**. I think that is not a very accurate one, that the networks are providing programming to the local station. They are, in fact, paying the local station to carry it. Tell me what is wrong with my analogy, which is that if the FCC access charge would be applied to Joe Diamond in the parking lot is that he could charge a user for wear and tear on the tarmac but that is all, only for where he could demonstrate that you had used something. But his property right, the fact that he owns that land and wants to charge you a fee for parking there would be something that under the FCC access charge wouldn't be permitted.

Why shouldn't local telephone companies, like PNB, be able to charge AT&T and Sprint and all the rest, all the resellers, a charge for not only what they specifically use but for the fact you own the phone company. They don't. You would charge them a proprietary fee for the use of your equipment?

Mr. **Pfeifer**. It gets back to what we talked about earlier, the bypass issue, because AT&T either becomes a bypasser by avoiding paying those rates or their customer builds their own network, uses existing satellites and bypasses eveybody so the contribution is a diminishing thing if you try to push an unnatural cost over on the user and I don't care what size it is. The problem you have is that the thing we have to come to grips with is, and I heard a lot of discussion this morning about prices and costs and so forth—let me point out that we know what the costs are but the costs have nothing to do with pricing in a regulated environment.

We must go through the regulatory process and when you get into a 90 cents and $12 discussion the fact is that the cost as I understand is 90 cents but where you get the balance of the money becomes the question. You either get the $12 on that other aspect of it or you go to the residence ratepayer and ask him to pay more for what they are incurring in terms of cost, and that is not something that is very desirable.

Mr. **Wyden**. Would the gentleman yield on that point?

On page 10 you state that when the mandatory measured service proposal came up, the Oregon Public Utility Commission staff did an independent cost study and you point to your cost studies and you bring them to the PUC. The PUC staff has already said for the record that they didn't do an independent cost study.

Mr. **Pfeifer**. That is correct. They review our pricing cost studies.

Mr. **Wyden**. So we are up on that.

Mr. **Pfeifer**. But they also accept the philosophies of our pricing and the figures. I heard the discussion this morning about the accounting system. That accounting system is established and required under the rules and regulations of the FCC. Now that again has nothing to do with pricing or costs. Accounting to meet the requirements of the FCC is one thing, which we are obliged to do under law. Pricing the products is something else, and we know precisely what the costs are.

The question is, can we charge the cost? Because if we did we would be charging the residence ratepayers about $28 a month.

Mr. **Wyden**. The Oregon Public Utility Commission has said for the record that it has not been able to do an independent cost study. On page 10 you say the PUC staff did an independent cost study. What actually went on is that they took your study and tried to review it.

Mr. **Pfeifer**. They made an independent study of our cost study is what they did.

Mr. **Swift**. I don't want to oversimplify your answer—if I understood you correctly you didn't disagree with the validity of the analogy but suggest that it got us into the bypass problem?

Mr. **Pfeifer**. I am not sure what the point of your analogy was at this moment. We don't do nearly as well as Joe Diamond does with his parking lots, and that is where you lost me.

Mr. **Swift**. You are right. Sometimes I feel I am subsidizing that. A couple more quick ones.

On page 5 you list as one of the subsidies that are going on now that in the business environment heavy users cost us more than light users and light business users subsidize heavy business users. That is 180 degrees from what an earlier witness suggested. Could you provide for the record some statistics that validate that?

If the other people are here, I would like to ask them to do the same. We just got a direct contradiction as to what the facts are.

Mr. **Pfeifer**. We can. I was talking to some of our folks yesterday about this problem. I said we ought to put a TV commercial together, and that becomes impossible because you are trying to tell too much in 30 seconds. If you can envision someone, say a stockbroker, using the phone to sell stock and they are on the phone 8 to 12 hours a day, and they pay a businessline fee for that line, contrast that to a barber, for example, who is cutting hair and occasionally the phone rings, he picks it up and marks down an appointment. He doesn't even originate the call, but the line cost is the same.

If you are worried about the barbers and gas station owners who have limited usage of calls and most of which the calls are incoming—the gentleman who sat here indicated he does a lot of business but they are incoming calls, there is no charge for those. But there is a tremendous distinction in usage between who is doing what with the network and that is all that the measured service concept attempts to deal with.

If we don't deal with it properly, or somebody has a better idea I am happy to hear that, but don't try to convince me that everybody ought to pay average in a competitive marketplace. It just isn't going to hold up over time.

Mr. SWIFT. At the bottom of page 8 you said with customer options like these the alarmist rhetoric calling for protection of universal services is ludicrous. I have heard that before. I have been called an alarmist on this issue a lot of times. I wish I could claim that the new awareness of the people we had on this other panel was something I had caused. I would love to be able to say that. I don't think that is true.

I guess what I am saying is that it would be fun to argue with you about whether your view of this matter is correct or theirs. But rather I suggest when you have retired people, poor people, residential customers, charitable organizations, when you have small businesses and all of them beginning to get very disturbed about this, we in my business find that something is going to happen. Even though we may be able to explain in exhaustive detail that everything is all right, if it is not perceived to be all right by the American public in a free society, things change. I would hope as we move down the line, you have enormous research facilities. I think you have been an honest and forthright advocate for a point of view throughout the past few years. But if we are able to move in a somewhat different direction than you would ideally like, I would hope that we could count on your being able to put those hours at the disposal of the public so we do not do something dumb. But it may be something different than you, under ideal circumstances would like to see.

Mr. PFEIFER. I understand what you are saying. I must say that I have a great deal of respect for you and your ability and your insight into the issues, and I think we have had a very positive working relationship even when we don't agree. But I have concerns when we deal with these issues and don't take into account the full ramifications of what we are talking about.

For example, on telephone rates we have, as a matter of record, submitted proposed legislation to Congress that would have dealt with the specific problems that specific people with specific needs have in terms of staying on the network. Where the problem arises is when you provide a universal subsidy for everybody and I become offended when I think that the proposal is going to end up subsidizing a California millionaire with a summer home on the San Juan Islands. I am concerned about the poor person, the senior citizen with limited income, and we have tried to address that issue and deal with that specific person and that specific problem. But we can't compete in this new world we are in and be subsidizing everybody whether they need help or not. We have to focus in on the real issue and deal with it.

Mr. SWIFT. It may be that neither of us has a tight grasp on the whole question.

My apologies to the rest of you. I am sorry that I have to leave.

I thank the chairman and my colleague, Congressman Skelton, for letting me interrupt the process this way.

Mr. WYDEN. It is our loss you have to go and we will be working with you in the days to come. Let us proceed back in order and we will have questions for everybody through the traditional arrangement.

Mr. Darryl Branstetter.

TESTIMONY OF DARRYL R. BRANSTETTER, DIVISION MANAGER, NETWORK SERVICES PRODUCT MANAGEMENT, PACIFIC BELL TELEPHONE CO.

Mr. BRANSTETTER. Thank you. My name is Darryl Branstetter. I am the division manager of network services product management for Pacific Bell, which is owned by Pacific Telesis. Pacific Bell represents the State of California. What I had put together in my written testimony I intend to summarize orally, basically answering sets of questions that you posed for us on our experiences with local measured service, mandatory local measured services, and our opinions relative to the access charge issue.

To begin with the local measured service issue, California has had mandatory local measured service for 60 years. It was first ordered in 1924 in Los Angeles, and I would like to read a quote from that order by a California commissioner at that point to set into perspective what their values were.

That order stated that measured service should be made effective for business and private branch exchange service in order to spread the charges equitably among the various classes of subscribers. Flat rates for business and private branch exchange service have become impracticable and place too great a burden on small users. That was words from that 1924 order.

Since that order we have worked with the California commission on an annual program to develop an extended measured service implementation throughout the State of California. Right now we are at approximately 90 percent of the business exchanges on measured service. Overall our analysis of the experience that we have had with small businesses specifically are that it is an important element of cost control and cost management that we add to their business. They don't have an uncontrolled set of expenses mandated by flat rates going up, they are able to manage their expenses to whatever level that they deem appropriate.

Like many others on the panels have said, it eliminates a cross subsidy; it is fair. Low users do not subsidize high users. You pay for what you use which is a concept that has been pushed and fairly well accepted in our jurisdiction specifically as it relates to measured service. The facts show that 73 percent of single-line businesses save money once converted to local measured service. The facts show that 59 percent of multiline business customers save money when converted to mandatory measured service.

Relative to access charges, we have tried to describe the issue of subsidies and cost allocation in my written testimony. I am not going to repeat all that. But the bottom line, we feel that access charges benefit the small business customer over the long-term. The FCC proposed structuring in the FCC docket 7872. The reason is because they reduce the threat of bypass and, as we have all stated, bypass and the subsidy that would be lost long-term will end up putting costs and charges on the small user business and residents. The access charge system needs to be implemented in order to continue to pave the way for reductions in toll rates. That is a step that has to happen in order for us to start reducing those toll rates so that the whole economic cycle can take place.

The access charge system is very easy to understand. It is a flat rate. It adheres to normal business practices where there is a flat charge to the customer of a fixed cost. In California the charge is $4.78, and relative to all the things that we heard from Mr. Pfeifer that in our mind is a small charge for the benefits that a long-term service access charge will allow. We feel that it needs to be implemented and avoids mortgaging the future for capitalizing on short-term issues. However, we are eager to participate in discussions of alternative recovery or transition mechanisms which consider the needs of the end user, the carriers, and the local telephone companies like Pacific Bell. We have not decided that the access charge plan is the only fair plan.

In California we have worked closely with the legislature and the Commission on the introduction of life-line service. We have implemented a service with special rate structures and subsidies for the resident user that has a limited income, and we have introduced and implemented that very successfully with legislation, but without Federal legislation. Our goal is to remain a viable company capable of meeting the needs of all our customers. We have got to keep that in perspective. And with that I close my remarks.

Mr. WYDEN. Thank you.

[Mr. Branstetter's prepared statement follows:]

PREPARED STATEMENT OF DARRYL R. BRANSTETTER, DIVISION MANAGER, NETWORK SERVICES PRODUCT MANAGEMENT, PACIFIC BELL TELEPHONE CO.

My name is Darryl R. Branstetter and I am the Division Manager of Network Services Product Management for Pacific Bell. I am responsible for a range of network products, including customer access services, exchange calling services, billing services, carrier access services, and special access services.

I am pleased to have the opportunity to share with this committee the success that we have had with mandatory local measured service (LMS) in California and to discuss our views on the FCC's access charge plan. My testimony is presented in a Question and Answer format, beginning with questions you may have about LMS.

Q1 Describe Pacific Bell's experience with mandatory LMS for business.

A1 On December 23, 1924, CPUC Decision No. 14420 required Pacific Telephone to discontinue flat rate service for all businesses in the Los Angeles exchange as of January 1, 1926. Since that date we have gradually expanded mandatory LMS for business customers located in exchanges with measuring capability. Today, 91% of our business customers are on mandatory LMS. All businesses' local calls will be measured by 1992.

Pacific has had virtually no problems with mandatory LMS for business. As an exchange is converted to LMS for the first time, according to the schedule in the Expanded Measured Service Program (approved annually by the CPUC), business customers are initially concerned about the change. Once measured service is implemented, however, concern quickly fades as our customers become used to the service and realize its benefits to them. Our business customers understand and accept the concept of "pay for what you use."

Q2 Please provide the per minute and per call charges of a local telephone call.

A2 The minute charges are as follows: 4 cents for the first minute and 1 cent for each additional minute. Based on the average length of a business call (3 minutes), the average per call charge is 6 cents.

Q3 Please estimate the per minute costs of a local call.

A3 The estimated cost of a non-measured local call is 5.2 cents for the first minute in comparison to the cost of a measured call of 5.9 cents. Each additional minute of conversation costs Pacific 1.2 cents whether the call is measured or not. This .7 cent difference in the initial minute cost reflects expenses incurred for measuring equipment, accounting, increased billing inquiries due to LMS, etc.

These costs are based on embedded direct cost studies. Embedded direct costs include operating expenses such as accounting, marketing, and network administration; and investment-related costs such as depreciation, taxes, interest, and maintenance. They do not include common costs or corporate overhead. The FCC requires Pacific to use fully allocated costs which include all overhead costs and, therefore, are higher than the costs we have presented here.

Q4 How are the local usage costs reflected in the billing structure?

A4 In a non-measured environment, business customers do not perceive that there are costs associated with local usage since they pay a flat fee of $17.15/month, which includes unlimited local usage. However, as shown in Question 3 above, there are indeed costs associated with local usage; there is no such thing as a "free" call. LMS "unbundles" exchange access from local usage and highlights the value of each of these separate services. With LMS, business customers pay $8.25/month to have access to the network, and then they are charged for their usage of the network based on the number of calls, the duration of the call, the distance (local vs. toll), and the time of day they are calling. Clearly, this type of charging makes sense from both a company and a customer point of view.

Q5 What are the benefits to the telephone company of mandatory measured service?

A5 In general, LMS provides increased revenue to Pacific and encourages our customers to use our network more efficiently.

Following is a comparison of the average per line bill for businesses with and without LMS. Because of this task force's special interest in small business customers, I show the figures for single line business customers separate from the figures for all business customers.

AVERAGE MONTHLY LOCAL USAGE CHARGES PER BUSINESS LINE

	NON-LMS CUSTOMERS	LMS CUSTOMERS
All Businesses	$6.93	$7.72
Single Line Businesses Only	$8.90	$5.96

It is interesting to note that while the average revenue per line for businesses as a whole increases as a result of mandatory LMS, average revenue from single line business customers decreases significantly. This results from the fact that under a flat rate system small businesses, who are generally moderate users of the local network, actually subsidize large business users who impose large costs on the network as a result of their high usage patterns.

In short, we have found that LMS is an efficient, effective, and fair way to charge customers for the actual costs that they impose as a result of their use of our local network.

Q6 What are the costs and benefits of LMS to small businesses?

A6 As I have just shown, small businesses are not adversely affected by LMS. In fact, our experience shows that over 73% of single line businesses realize a cost savings as a result of LMS. This is due to the predominance of small businesses that serve local communities, for example, grocers, barbers, dry cleaners, restaurant owners, and even libraries. These businesses do not rely on the telephone network for outgoing calls as much as they do for incoming calls, for which they pay nothing. The flat rate system, in effect, charges these customers for an average number of outgoing calls made by business customers as a whole. To the extent that these businesses make fewer calls than average, they are better off under LMS.

A small number of small businesses (about 27%) are very high local users, for example, some gas stations, realtors, and attorneys. These customers often have higher bills under LMS. However, we feel it is fair that these large users pay for the costs of their use through LMS, rather than imposing these costs on others through a flat rate system.

By contrast, 59% of multi-line business customers save money when they switch to LMS. This shows that while a majority of all customers benefit from LMS, these benefits are even more pronounced and more widespread among small business customers.

An additional benefit of LMS to large and small business customers is the flexibility it gives them to monitor and control their telephone expenditures.

As I have stated, we feel that LMS is a fairer system for all customers. By charging higher prices only to customers who impose high costs on the network, we have been able to keep prices lower for the large majority of our customers who use the network moderately. LMS eliminates unfair "cross-subsidies" among local users.

Q7 What are your views of the "long-distance" access charges imposed by the FCC? How does this system impact small business customers?

A7 First, I would like to clear up some misconceptions about "access" charges. I feel that a little history and explanation of the origin of these charges will help this committee understand the wisdom of the FCC plan and the detrimental effect of alternative plans on small business customers.

Contrary to popular belief, so-called "long-distance access" charges are only loosely related to the provision of long-distance service, and are in no way meant as compensation for costs associated with the long distance network or access to it.

As described in testimony submitted to this committee by the United States Telephone Association, these charges are derived via a separations formula. This formula merely dictates that a certain percentage of the fixed costs of the local network will be recovered via charges imposed from the interstate jurisdiction. This system was originally designed to ensure that long-distance services helped subsidize the fixed costs of the expensive local network, in an attempt to keep basic exchange rates low. As a result, the prices for long distance service were "loaded" with this subsidy on a per call or per minute of use basis.

In the days before the explosion of telecommunications technology, this system resulted in large users of long-distance services contributing many times the amount contributed by smaller users, even though the costs of providing network access are unrelated to use.

In fact, fixed local network costs are incurred as a result of a customer's decision to subscribe to local exchange service--whether or not that customer ever makes a long-distance, or, for that matter, a local call. In other words, these costs are not related to the number of calls, if any, that the subscriber makes.

As a result of the technological advances in telecommunications: microwave, fiber optics, etc., large users of long-distance services now have available to them relatively low-cost ways to provide their own services, if they choose to. This means that they are now able to avoid paying the subsidies that have been historically attached to long distance rates. This is known as "bypass".

The real danger of bypass is to residential and small business customers--the ones previously subsidized under the old system. As more and more large customers bypass, the fixed costs of the network (which are not reduced as large customers disconnect) must be spread across fewer and fewer customers, driving rates higher and higher, until the entire cost of the network must be borne only by the people who are unable to build their own bypass system: residents and small business customers.

Recognizing this bypass threat, the FCC designed a system to relieve the burden that had been borne by large customers under the old AT&T procedure. This system distributes the fixed network costs allocated to the interstate jurisdiction to all customers on a flat rate basis: $4.78/per line in California. This is what we call the "access charge". It is expected that this redirection of the costs for local connections will keep most of the large business customers on our network by reducing their incentive to bypass. If we are not successful, the alternative to paying this small charge now may be future rate increases many times the current charge if large users leave the local telephone companies with stranded costs which must be paid for by the remaining subscribers.

For these reasons, we feel that it is fair, necessary, and in the best interests of small business customers to pay this relatively small per line charge.

Of course, we realize that it is sometimes necessary for public policy makers to protect disadvantaged people from such charges even though it may be economically rational for them to pay these charges. For this reason, I have included a brief discussion of some of the problems inherent in an exemption system for small business such as the one temporarily imposed by the FCC:

- There is no clear-cut definition of "small business." This is not a trivial problem. One part of this problem is in defining a "business entity." For example, because a single customer may have many billing numbers, it is difficult to know if two billing numbers are related to a single customer. Is a shoe store with a branch in two cities one customer or two? Many large multi-line customers have separate billing numbers for various parts of their business. If the customer name is spelled differently, or the customer has many locations within a single serving area, the local telephone company has no way of knowing if many billing numbers in fact are associated with a single customer entity.

The second part of this problem is in defining "small." Definitions based upon the number of telephone lines the business subscribes to are arbitrary, discriminatory, and do not guarantee that the "right" customers are exempted. Other measures of "smallness" or "need" such as company income, profitability, etc. are equally arbitrary and tend to reward inefficient or poorly run companies. The question becomes one of defining and identifying not only who is "needy" but also who is "worthy" or "deserving." We addressed this issue when we designed our Lifeline program for low income residential customers. This program provides telephone service at half the measured rate to needy residential customers. In this case, income provides an objective and reliable measure of need. No such measure exists for small business customers.

Remember that any exemption results in other customers bearing a larger portion of network costs. Any error in identifying "needy" business customers therefore results in a subsidy paid by customers who may actually be worse off than those exempted. In addition, to the extent that those providing the subsidy can choose to bypass the system, all remaining subscribers, whether subsidized or not, wind up paying for a larger portion of fixed network costs.

o Because local telephone companies are not in the business of providing or administering such subsidy programs, the costs of such programs are enormous. Even if the definition of a "customer entity" is provided, the administrative costs of setting up and maintaining an exemption system are large. For example, just establishing a system to identify multi-line business customers according to the FCC access charge order cost Pacific over $250,000. Because this system was meant to be temporary, it includes many manual systems which are costly to operate, and even more costly to automate. A permanent system of this type would cost many millions of dollars, which, of course, must be ultimately borne by the ratepayer.

I think you can see by these examples that such systems are difficult to administer and may ultimately cost the ratepayer more than it saves him or her. We feel that the

$4.78/line charge is not so burdensome that it warrants such extreme measures.

However, Pacific is actively involved in discussions regarding alternatives in recovering our fixed network costs. Whatever the outcome of these decisions, the same amount of costs must be recovered no matter who designs the recovery mechanism. Moreover, basic business sense tells us that fixed costs must be recovered via fixed charges borne by all subscribers to the network. Any other system encourages large users to bypass the network, to the detriment of all.

This concludes my prepared testimony to the House of Representatives's Committee on Small Business. I commend the committee for its interest in these important issues and I hope this testimony will prove helpful in this investigation.

Mr. WYDEN. Mr. Perry Swisher.

TESTIMONY OF PERRY SWISHER, PRESIDENT, IDAHO PUBLIC UTILITIES COMMISSION

Mr. SWISHER. Mr. Chairman, I am the only regulator you have today amidst all these communications people. The first thing I noticed in coming to your hearing was that you were not in the north auditorium but you were in the south auditorium. There was no sign on the door of the north auditorium to tell me where you were meeting and nothing could be more appropriate for the subject at hand.

I am so concerned with the bad state of the art of communication between the State regulator and the Congress and the FCC and those operating company people who still think we are with AT&T that I would appreciate it if I could be permitted to react to what I have heard so far as a regulator and let my remarks be spread as you offered at the beginning. I do hope you read them. They have to do with the whole concern of the nonmetropolitan States with what is perceived to be deregulation.

I personally thank God that whoever thought up MCI was interested in long distance and not in electricity, because if that same person had set up a large induction coil under one of the high TV lines of one of the utilities we have regulated, he would then have announced to the world I have some very cheap electricity I want to sell you. Because he would not have had to invest in facilities, he would simply have ripped off an existing working system. It is called grand theft in the electric utility business. It was called a business opportunity in telecommunications and much of what followed on and much of what Congress did, much of what Judge Green did and almost all of what the FCC has done has been to formalize and legalize, not for the first time in the history of the country, the opportunity to expropriate what was already put in place or what the Indians had when we got here.

It was a "rip." "Rip" has been legalized and now the more sanguine people in AT&T chose for their careers the pursuit of unregulated portions of the telecommunications industry. As I left for this meeting, from Boise, the word came in from Texas that AT&T, only 8 months after divestiture, is proposing to give you the same high quality service that you get when you call on MCI or Sprint and you get those hollow sounds and uneven decibel readings. In order to resolve a rate problem before the Texas Commission, AT&T has asked to go back to what is called feature group B for their services, which simply means that within 8 months, Mr. Chairman, AT&T is moving the quality of telecommunications back in this attempt to be more competitive and moving the quality back to a lower level to where it was several years ago.

It is difficult to communicate to the Congress what the regulator sees month by month in this Balkanization of service that is beginning and some of the deterioration of service in the parallel movement in high tech to some enormous forward steps in what we can do with the telecommunications system alongside the beginning—it isn't any longer a threat, no longer paranoia, but the beginning of the end of what was in place with respect to universal service.

It is like the time that Democrats and Republicans and Kennedys and Kemps all joined together with the Alfred Kahns of the world in a big euphoric orgy of deregulation of airlines. We had the same sorts of reactions in the nonmetropolitan parts of this country. We weren't heard. I don't expect we will be heard this time, but I must tell you it is very difficult to get to Seattle from Boise by plane on any kind of a rational schedule, and it is going to be true in unpredictable ways that the quality of what was a beautifully integrated system is now in the process of deterioration no matter what is being accomplished in high tech, that the universal grid and the way it works, without some drastic remedy, will no longer be what it was and in fact it already is not.

Thank you, Mr. Chairman.

Mr. **Wyden**. Thank you very much.

[Mr. Swisher's prepared statement follows:]

PREPARED STATEMENT OF PERRY SWISHER, PRESIDENT, IDAHO PUBLIC UTILITIES COMMISSION

Prepared testimony of Commissioner Perry Swisher on Telecommunications changes, before the germane task force of the House Committee on Small Business, August 23, 1984, at Seattle.

When the consent decree ordained the divestiture at American Telephone & Telegraph, I was president of the Idaho Public Utilities Commission. I continue to serve on our three-member commission. Conley Ward, Jr. is the president but he is unable to be here. Commissioner Richard High is the third member.

All of us were serving when the court's order came down. My name is Perry Swisher; I also serve on the executive committee of the National Association of Regulatory Utility Commissioners.

State regulators are living with a chronic paradox. This is widely believed to be an era of de-regulation, of federal initiative to replace systematic allocation of costs and benefits with competitive, market forces. But in truth, most of "de-regulation" relies instead on federal standardization at the expense of local diversity, on federal preemption of traditional options, on federal default from responsibility for citizen access to the airways and railways and bus routes and roadways and communications channels.

Idaho is a big state, but contains only 800-thousand some people. In Idaho there is no need to wait a decade to review the gap between the theory of such de-regulation and the effects on small business. A small business no longer knows, month to month, when and whether the so-called scheduled flights of feeder airlines will really occur. Business and professional people by the thousands commute to the airports at Salt Lake City and Spokane. These aren't out-of-state in the New England or D.C. area sense. No, often you drive the distance from Philadelphia or New York to Washington, D.C., and beyond, to get in the air.

Almost weekly, we eliminate less-than-truckload authority for one common carrier or another. The route-abandonment proposals of national bus lines indicate that Greyhound wants to fly over Idaho. Since the merger of Union Pacific and Missouri-Pacific, that system and Burlington Northern are replacing station agents with 800 numbers and computer terminals. Except for the transcontinental main lines, nearly all rail track will be gone in a few years at the present pace of branch line abandonment. Obsession with near-term earnings and fast depreciation is diverting investment dollars into other opportunities. Arterial competition is at times breathtaking, but we whose states produce commodities and minerals watch the veins wither and wonder if in the long run the body politic and economic will remain healthy.

The obligations of utilities and carriers under the balanced franchise concept--reaching the extremities because they contribute to the organic whole--are being set aside. Short-term opportunity at the expense of long-term viability runs counter to our new reverence for long-term planning. Another paradox.

On the specific subject of today's hearing, I know that Judge Greene ordered that the ratepayers of the operating companies are not to endure costs beyond those they would have experienced without divestiture. I also know that in the 1984 test year for Mountain Bell is southern Idaho the FCC depreciation preemption, both remaining life and equal-life group, costs an estimated $2,661,000. To oversimplify, the reality of divestiture and the capital-recovery exigencies mandated by the FCC also meant that $5.6 million in Mountain Bell's 1983 Idaho rate case had to be covered by rate increases. We do not yet know what the impact of the latest AT&T proposal, average-age depreciation, will be. I assume from experience that what AT&T proposes the FCC disposes until events prove otherwise, as in the pleasant exception when FCC backed off from imposing an access fee on every ratepayer although--unpleasant--it did sock it to small business, $6 a month per line for those with two or more lines.

To test the theory that access to the network is a plus for the phone customer and a bother to the industry, the Idaho Commission ordered Mountain Bell to file a tariff for customers who choose not to put the industry to the expense of supplying them with access. In other words, if a telephone-utility customer opted not to call beyond the LATA, how much less would the monthly service charge be? The tariff has yet to be filed, and we haven't pushed it. We have no desire to pull people off the long-distance network, quite the opposite. But we are making the point that in an integrated system the benefits flow both ways. Breaking a wholly integrated entity into parts arbitrarily labeled as cost causers and revenue producers was false semantics, Newspeak to justify the bust-up.

Some of the inconveniences caused by divestiture will be resolved. Bills too complicated for householders to sort out are also eating up costly time in business offices, but within a few months, I'm sure, most of us will see bills we can understand.

Frustration will remain. A small business doesn't have the technical staff to tell the boss: which supplier to contact about equipment problems; about inside versus outside wiring; about ownership versus lease versus service contract; which costs are set by tariff and what is unregulated; how costs of extension to a new location are calculated; how they may be shared with other prospective new customers at that site; why it can cost more to move phones across the hall than to move them into a new high rise.

These are new mysteries. To assure entrepreneurs that costs (and the complexity) are driven by market forces is to undermine their faith in free enterprise, because the end results are turning out to be greater costs, counter-productive consumption of time in decision-making, and higher susceptibility to an overnight obsolescence of new capital investment.

There are some trivial pursuits. When we encouraged phone customers to buy their phone sets before D-Day, hundreds of Idaho residents with amplifiers for the hard-of-hearing assumed they also bought the amplifier. They didn't, it turns out. We have yet to strike an agreement with AT&T so AT&T won't be spending more to collect rent on those little gizmos than they get back. The new AT&T is hard of hearing.

There are bigger things. One example. REA was created to get the lines out to remote locations. REA field personnel continue to encourage projects on which a small independent telephone company could make recovery from the toll settlements. But now the money won't be there. Because the new technologies can serve truly isolated sites at less cost than stringing a cable, we were reviewing such proposals before divestiture. Currently, Midvale Telephone Co., an independent, seeks to extend its service to 30 prospective customers at Yellow Pine on the edge of the Idaho wilderness. The up front cost by my estimate cannot be less than $10,000 per new customer.

Instead, we should be able to adapt the proven techniques of Alaska's modern pioneers to the lower 48. An earth station beaming in on a fixed-orbit satellite links tiny fishing villages with phones and data systems and television channels. We can do the same thing for the new gas fields, resorts, mining camps and outdoor jumping-off places in the inland West. Instead of letting the post-divestiture muddle bog us down, we should move along where we can. Calmly viewed, technology offers economic opportunities by making telecommunications so pervasive that society is reachable, at your option, when you yourself are two mountain ranges away from the rest of us.

A decision was reached in Idaho fortunately before the consent decrees, to make one-party service available to absolutely every customer on the Mountain Bell system that serves two-thirds of our population. OPUS, or one-party universal service as we dubbed it and as it is now known nationally, will be in place by 1986. Thus you can work seasonally or the year around in the setting of your choice, using virtually all of the telecommunication amenities available in, say, Los Angeles.

A new life style is emerging in the West, giving us entry into the landscape without bulldozing it, fitting individuals into the environment without incrementally obliterating that environment. OPUS contributes to that. It is a reality, not a theory, in the beautiful lake country of the Idaho panhandle, beside the trout streams west and north of Yellowstone Park, around Sun Valley. Uneasy, we treat it as a secret, but this is a remarkable turnabout, like American Indians invading industrial England to save Sherwood Forest.

Facing unquantified *** monthly service charge increases mandated by the divestiture thesis--that toll revenues will float free and backbone plant be financed by "cost causers," or people as we used to call them--a post-divestiture regulator is reluctant to order the kind of system enhancements OPUS represents.

The answer isn't to retreat to the same toll formulas that caused small outfits to make casual investments paid off by all of us while their residential customers continued to pay monthly bills in single figures. The answer isn't to impose measured service on everyone. Maybe we shouldn't have arrived at this juncture so thoughtlessly, but the social assumptions surrounding local line use are now as ingrained as if they were in the Bill of Rights.

Place all households on measured service? Can the lawyers equip us with a new code allowing parents with, say, three children in puberty to obtain a divorce from their offspring? It's that or sell the family car to pay the phone bill.

If measured service becomes universal for business, are the regulators and the operating companies prepared to create half a hundred classes of commercial customers?

Whether the subject is electricity, phones, cable, water or natural gas, small business is conspicuously absent from the regulatory hearing room. One reason is that a utility bill has lower priority than taxes, payroll, leasehold costs and inventory, all bigitems. And diversity is so great that businesses united on one issue are divided on another. A consequence of that absence is that, lacking the evidentiary record small business would supply if it were present, we regulators and the courts require the commercial class to pay more than its proportionate cost of service. It's a matter of default, not intent. When a rationale is heard it is that business can "pass it on."

A truism that broad is untrue. Some categories extract a hundred times more usage from a phone line than someone else but pay the same rate; from that you are right to infer that some measurement will now evolve but nothing like pure measured service.

To close, I suggest some objectives for small business in the expectation that they are also in the public interest:

1. Operating-company system enhancements that open up new services and uses deserve some support from the stream of toll revenues.
2. Operating companies, and those with whom they contract, should be able to offer one-shop-stop services for maintenance and remodeling of lines and hardware.
3. Similarly, anti-trust measures should not become automatic barriers against common-sense efficiencies in managing one's own premises.

4. The acceptance of line-counting access charges on business, while lifeline is being debated congressionally for low-income households and high-cost states, should be acknowledged for what it is, a consideration of a modest form of nationalization of residential service. Don't buy it if you don't like it.
5. Consider mandating the standards for inside wiring in the local and state building codes, thereby lowering up-front charges that today are the least manageable expenses imposed by divestiture upon any business person who dares to move a desk.

Thank you for inviting me.

Mr. WYDEN. Our next witness, Dr. Bridger Mitchell, senior economist, Rand Corp., Santa Monica.

TESTIMONY OF BRIDGER M. MITCHELL, SENIOR ECONOMIST, THE RAND CORP.

Mr. MITCHELL. The Rand Corp. is a nonprofit organization chartered to conduct research in the public interest. For the last several years, funded by research grants from the National Science Foundation and a grant from GTE Service Corp., we have studied the economics of measured service pricing of local telephone service. Our findings have been published and also presented at conferences on telecommunications. I would like to briefly summarize some of those findings for you. I will be speaking as an individual, not as a representative of Rand or of its research sponsors.

Because time is short I will skip through the distributed testimony, which unfortunately it was not possible for me to prepare specifically for this hearing. It is a short paper which I delivered to a conference on local telephone pricing in Montreal earlier this year.

Also, I must apologize to the audience. There is a missing figure that somehow escaped our reproduction process. We would be happy to supply a complete paper to anyone who would care to write to us at our letterhead address and for the record I will be supplying a corrected version for you. I am going to focus in the few minutes I have on an economic perspective on telephone pricing and particularly on questions of efficiency.

The telephone industry by and large is the most capital intensive industry in the economy, and this places particular emphasis on making effective and efficient use of resources if telephone service is to be delivered at high quality and low cost. I suggest in the paper that there are three important questions to be looked at, the extent to which measured service is in fact a more efficient way of making use of telephone resources than flat rate pricing; second, whether measured service is a fairer way of charging for telephone service; and, third, whether measured service will in fact increase or perhaps decrease access to the telephone network.

Let me focus largely on efficiency. If we have time and care to take them up we can discuss the other two questions later.

To note whether measured service would result in a more efficient use of the resources that we have invested in the telephone system we need to understand several basic factors. What is it that causes an increase in the real cost of supplying telephone service? Whether and to what extent measured service affects these factors and thus reduces telephone costs by charging for telephone use? What are the new costs of measured service—that is the costs of doing the pricing and billing customers for their usage? And finally, what value subscribers will lose when they must pay for each telephone call? It is those four components that make up an integrated analysis of economic efficiency.

To do this in full scale is a substantial undertaking. It would need to be done for each jurisdiction, so I can only speak about the general principle this morning. Local telephone costs are determined by the technology of the telephone system. And apart from inflation, the total costs of local telephone service increase in two major circumstances. First, telephone costs are increased when more telephone lines are added to the network. I will be speaking entirely about local telephone costs here, not long distance. So when more telephone lines are added either to serve new subscribers or to increase the number of lines for existing subscribers, additional outside plant, local loops, and switching connections must be provided. These are the costs of access to the telephone network itself, costs that are incurred even if no calls are made at all on the new lines. They are incurred when the lines are put in.

The second circumstance in which telephone costs increase is when the telephone company must expand the capacity of the network to handle a greater volume of telephone calls. Now, additional capacity is required at the peak hours of the year to avoid delays—the busy signals that would otherwise result from a greater volume of calling and a fixed amount of capacity. But this greater capacity is available 24 hours a day every day of the year and is thus usable by callers at all times.

The consequence of these two fundamental types of costs in the cost structure of a local telephone company are that most local calls are essentially costless. Most hours of the year no additional capacity is needed. There is excess capacity available if consumers want to make more telephone calls, and there is only a very small cost in terms of additional electricity and maintenance required to actually keep the system running and provide additional calls.

But the flip side of that consequence is that at the very peak hours of the year additional calling requires greater capacity or causes a deterioration of service, so to maintain some designed standard of service, additional expensive capacity—additional switching equipment and some additional trunking—must be added to the system.

Measured service does affect the use of the telephone. Several recent studies have measured quantitatively the extent to which subscribers, primarily residential subscribers and not business, have responded to new measured service rate structures. Both the number of calls and to a lesser extent the number of minutes of use per call are reduced when subscribers are charged for calls and for minutes of calling. On the other hand, demand by business subscribers is decidedly price inelastic.

There is one additional, important cost of local telephone service if measured service pricing is used to collect revenues, and that is the cost of doing the measuring and the billing for local calls. Flat-rate pricing does have the virtue of simplicity. When you are giving a service away, you don't have to keep track of how much of it the customer uses. But to charge for local calls you must measure each one of them using much the same technology that is needed to measure toll calls.

Some of the other testimony today reports estimates of what those measuring costs are and in some jurisdictions they are on the order of one-third to one-half a cent per call. In any case, the extra costs of measuring and billing local calls are significant. Today, measuring costs to remain a major impediment to achieving widespread increases in efficiency through measured service.

The fourth factor is that subscribes will lose something by having to pay for measured service. Some of the calls they would have made when telephone service is available under flat rates will no longer be made. Those calls are worth something to subscribers, although they are not worth as much as the price they have to pay for them, and that represents a genuine loss in benefit.

Let me, then, summarize the effect of measured service on economic efficiency. Measured service will reduce the number of peak-hour local telephone calls. This lower demand will allow the telephone system to save costs by deferring plant expansion of switching and trunking capacity that is needed to complete local telephone calls.

Measured service may promote network access and increase the number of subscribers, thus increasing the value of the network to other subscribers. Subscribers will make somewhat fewer calls, those worth less than the measured service charges, and here subscribers will lose something of value.

Finally, the telephone company will incur new costs for metering and billing to local calls. Clearly there are some pluses and some minuses, and the net effect will depend on the particular circumstances of the rate structure and the cost structure in the jurisdiction that is being examined. The best that I can suggest to you this morning is a rather general principle that measured service will provide a net increase in economic efficiency only if the total cost savings to a telephone company exceed the extra costs of measuring and billing the local calls.

Now, by how much they would have to exceed the measuing and billing costs in order to achieve a net benefit will depend on the particular circumstances. In very simple analyses one can deduce that it must be roughly twice the cost of measuring and billing in order to get a net benefit, that is to make up the loss in value to consumers of having to pay for individual calls.

I wouldn't want you to think that that is a magic number but rather to keep in mind that the cost savings, the benefits lost to subscribers and the costs of measurement all have to be carefully brought into the equation along with when those costs are incurred.

One could use this as one principle for assessing fairness. The question as to whether paying for what you use is a fair way of charging for telephone service might be posed as whether greater use actually causes greater cost. Well, in the peak hours, that is certainly the case—extra capacity must be in place. But for many hours of the year greater usage does not effectively increase the cost of the telephone service and at those times charges for usage would not be cost based.

Thank you.

[Mr. Mitchell's prepared statement follows:]

PREPARED STATEMENT OF BRIDGER M. MITCHELL, SENIOR ECONOMIST, THE RAND CORPORATION

Outside of North America telephone administrations have long used several forms of Local Measured Service. But in the United States, where LMS pricing has frequently applied to business subscribers, residential telephone service is supplied mostly at flat rates, except in only a few urban areas. Recently, however, telephone companies have proposed LMS plans in many jurisdictions.

At several sites, telephone company staff and independent researchers have conducted detailed studies of local telephone conditions. These studies have expanded our knowledge about telephone demand and cost and provide a factual basis for addressing basic pricing issues. Several conference papers report detailed findings from some of these studies.

In this paper I will outline a framework for examining the topic "What is LMS?" from an economic perspective. This framework will not, in itself, answer that question. Rather, I hope to give the reader a basis for assessing the findings of these studies.

To address the question "What is LMS?" I will examine three others:

1. *Is LMS more efficient*? That is, will converting from a flat-rate pricing structure for local telephone calls to a charge for each call improve the use of economic resources?

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[1] Presented at the conference "Local Telephone Pricing: Is There a Better Way?," Montreal, May 2-4, 1984.

2. *Is LMS fairer?* Is charging people for their actual use of the telephone more equitable than charging them a fixed amount for simply being subscribers?
3. *Does LMS increase telephone access?* Will per-call charges with lower minimum monthly bills increase the number of subscribers; can LMS prevent a loss of subscribers if the overall level of local rates rises?

IS LMS MORE EFFICIENT?

Local telephone calls are the most frequently used utility service that is sold at a zero price in the U.S. and Canada. One might expect such a billing arrangement to cause a significant loss of economic welfare. But the combination of highly price-inelastic demand and high costs of billing every call could make flat-rate pricing optimal.

To know whether LMS would result in a more efficient use of resources we must understand:

- what factors cause an increase in the real (inflation-adjusted) costs of supplying telephone service
- whether, and to what extent, LMS affects these factors and thus reduces telephone costs
- what the new costs of an LMS pricing system itself are
- what value subscribers lose when they must pay for each call

A complete economic analysis of LMS should encompass all of these elements and requires a full-scale investigation. Many key facts are yet to be determined and may well vary from one location to another. Nevertheless, the basic framework for undertaking this analysis is well established.[2]

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[2] Mitchell (1978, 1981).

The Marginal Costs of Local Telephone Calls

Local telephone costs are determined by the technology of the telephone system. In functional terms the major cost-generating elements are

- connecting a subscriber to the network
- connecting a subscriber-dialed call to the dialed party
- ongoing operation and maintenance activities
- measuring and billing for local calls

To determine how much revenue is required for the telephone company to earn a normal return, total costs are essential. However, it is *marginal* costs--the change in total costs--that matter when comparing LMS with flat-rate pricing. Only if total costs are reduced can LMS potentially increase economic efficiency.

The major changes in total costs occur when new subscribers are added to the network and when capacity is expanded to handle more busy-hour calls. As a result, an increase in calling during peak (busy-hour) periods will have high marginal costs and will either require capacity to be expanded or cause service quality to deteriorate.

Fig. 1 is a sketch of the local telephone equipment needed for subscriber A to call subscriber B, both served by the same switching machine, and to call subscriber C in another area of the city served by a different switch. The A-to-B call requires the services of each subscriber's telephone terminal and local loop, and uses some switching capacity. With modern stored-program-control switching this capacity is occupied for a short period needed to make the connection; it then becomes available to handle another call. Thus, when the switch is loaded to capacity, additional equipment will be needed to service more calls. However, no more equipment is needed to provide for longer-duration calls.

The A-to-C call must pass through two switches connected by inter-office trunk lines. In this case, when the trunks are fully occupied, longer calls as well as additional calls will require an expansion of capacity.

However, during most hours of the day (and even at peak hours on most days of the year), there is sufficient capacity to accommodate additional calling. At these times the only incremental cost due to greater calling is a small amount of added maintenance.

The effect of local telephone use on costs is therefore quite mixed. Most local calls are essentially *costless*. But those made at the very peak hours of the year have quite high marginal costs. And for many of those calls, longer conversations (whether person-to-person or computer-to-computer) have little effect on costs.

How LMS Affects Telephone Use

Several recent studies have measured how telephone subscribers respond to the introduction of LMS. The demand for both the number of local telephone calls and for minutes of use is sensitive to price, but decidedly inelastic. LMS does indeed cause customers to reduce the number of local calls per month, and residential households with patterns of heavy usage make proportionately larger reductions.[3] On the other hand, demand by business subscribers is decidedly inelastic.

In communities where telephone companies have offered LMS as an option to flat-rate service, which service a subscriber chooses depends greatly on the price of the flat-rate alternative and his pattern of telephone use. It also appears to include a readiness to pay a "premium" to retain flat-rate price. As a result, unless the flat rate is substantially higher than the minimum LMS rate, only a small proportion of lower-usage customers select LMS. For this reason, many optional LMS plans scarcely affect the total capacity costs of local service.[4]

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[3] Park, Wetzel, Mitchell (1983); Park, Mitchell, Wetzel, Alleman (1983).

The Costs of LMS Pricing

Flat-rate pricing has the virtue of simplicity--when you are giving a service away, you don't have to keep track of how much of it the customer uses. Conversely, to charge for local calls you must measure them, using much the same technology that is needed to measure toll calls. For customers served by electromechanical switches, this requires adding special data-collecting computers; in modern computer-switching centers it means installing added software and using some of the computer's processing time for data collection and processing.

Processing and billing these measured calls can require a major increase in accounting and data processing, a significant new activity, because there are about 10 local calls for each long-distance call. Thus, the extra costs of measuring and billing local calls are significant. In areas with more than a small proportion of older switching machines these costs can easily exceed the savings of greater telephone plant efficiency. For computer-controlled telephone offices, costs have been falling, but not as rapidly as many in the industry had expected. Today, measuring costs remain a major impediment to achieving widespread increases in efficiency through LMS.

The Loss to Subscribers from LMS

Having to pay for telephone service that was previously free-of-charge somewhat reduces its value to subscribers. Under LMS, consumers will make fewer calls and perhaps shorten some conversations. These unmade calls are valuable (although each must be worth less than the LMS price of a call) and the loss of this value represents the consumer surplus that is foregone when LMS is introduced.

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[4] Mitchell and Park (1981).

If LMS is economically more efficient than flat-rate pricing, it is because the savings in capacity costs plus any benefits of expanded access exceed the costs of measuring calls plus the subscribers' value of unmade calls.

IS LMS A FAIRER METHOD OF CHARGING FOR LOCAL TELEPHONE USE?

One's answer to a question of fairness will depend on his views of equity--how society should share the total costs of local telephone service. There are several major alternatives.

1. Pay for the costs that your telephone causes. According to this principle, paying for what you use *seems* fair. If one person's activities cause increased costs, the resources available to produce useful goods and services for others are diminished. But as noted, for many local telephone calls, greater use imposes no added costs. To be consistent with the cost-causation principle, usage-sensitive rates must be carefully designed to charge for only those calls that actually cause higher costs. Such rates would not distinguish the type of subscriber--business and residential users would pay the same rate.
2. Discriminate between subscribers according to thei [illegible] of the service or their ability to pay for it. This principle has long been used to justify charging businesses more than residences, and to offer preferential rates based on income, age or personal handicap.
3. A third possibility is to adopt an egalitarian rate--charge everyone the same price--one phone, one price.

Each person must make his or her own assessment of the fairness question, keeping in mind that local telephone use varies enormously. In any category of subscribers--retired couples, families with young children, high-income singles, etc.--substantial numbers of households make only a few local calls a month, while others talk almost constantly. As a result, LMS will both reduce and increase bills for some members of every group.

HOW DOES LMS AFFECT ACCESS TO THE TELEPHONE NETWORK?

A communications network is one of the clearest cases of an economic externality--a one-person network would be of value only to an egotist, but as the network expands its value to every subscriber increases. In principle, subscribers would be willing to pay something (perhaps not very much) to increase the reach of the telephone network, or to prevent it from shrinking.[1]

Low residential flat rates have long been used to promote access in the U.S. and Canada. If LMS lowers the basic entry price--the fixed monthly charge--will new subscribers join the network? The demand for network access, as well as the demand for local calls, has some price elasticity, and if there were no other price change, the network would indeed expand. But because LMS also imposes a per-call, or per-minute charge, the net effect is not clear. LMS does make access--connection to the network--less costly. But this, in itself, may not be sufficiently valued by marginal consumers to induce them to subscribe. Some will value telephone access mostly because they wish to make a large number of calls, and the cost of this intended usage may be at least as great as the previous flat rate.

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[1] Accessibility, rather than access, may be the more appropriate measure of the network externality. In addition to a telephone in the residence, telephone network accessibility is increased by wider availability of public (coin) telephones and opportunities to share telephones.

THE NET EFFECT OF LMS ON RESOURCE USE

Let me summarize the effect of LMS on economic efficiency:

- LMS will reduce the number of peak-hour local telephone calls. This lower demand will allow the telephone system to save costs by deferring planned expansion of the switching and trunking capacity needed to complete local calls.
- LMS may promote network access and increase the number of subscribers, thus increasing the value of the network for other subscribers.
- Subscribers will make somewhat fewer calls--those worth less that the LMS usage charges. Because these calls are indeed worth something (but less than the LMS charge), subscribers lose here.
- And the telephone company will incur new costs for metering and billing the local calls.

Evaluating the net effect in any particular region will require detailed study. However, the following general principle may be applicable:

> LMS will provide a net increase in efficiency if the total cost savings to the telephone company exceed, by a multiple, the extra costs of measuring and billing local calls.[1]

Under simplified conditions the multiple is *two*--that is, total savings must be at least twice the extra costs of measurement for LMS to be a net gain. This twofold factor will probably not hold exactly in a detailed analysis, but it provides a useful initial rule-of-thumb and reminds us that complete assessment of LMS must include consumers' welfare as well as the costs of the telephone company.

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[1] See Mitchell (1979).

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Mr. **Wyden**. Thank you for thoughtful testimony.

Gene, as Al indicated, your testimony has certainly got everybody's attention. I read it last night and the first thing I thought about was the old story about Bobby Kennedy. One day when he was campaigning for President he went to a big rally and everybody clapped. He sits in the front with Ethel and as soon as he sits down one guy in the front of the room stands up and says, "Bobby, you are a jerk, you are a bum, you are a no good. I would never support you for President." And he turns to Ethel and he says, "Well, Ethel, I guess it won't be unanimous this year." I know we have got some differences of opinion. I did read your testimony very thoughtfully. I looked at the part, for example, about how you feel, some of us, I and others, are ludicrous in being concerned about the implications of what is happening to universal service. I compare that to what I was asked to do last weekend, to dedicate a community phone where people not in the Bronx or in Chicago or somewhere else but in my district couldn't afford a phone, so I think we have a real problem on our hands and I am anxious to work with the company.

In fact, I spent a substantial amount of yesterday afternoon in the office in Portland looking at alternatives and talking about where we are going. People have differences of opinion, and we need to try to reason them out. One point I want to get straight in my mind is that the company supports access charges for long-distance and also supports mandatory measured service for local. The basic premise for that, having now talked to you all a fair amount of time, you support access charges because costs are fixed and you support measured service because costs aren't fixed, and I am a little confused on that point and I want to go through it so we understand it even from a technical standpoint.

For the long-distance calls, according to the company position, the local loop is nontraffic sensitive. It has got to be in place regardless of how many long-distance calls are made.

Mr. **Pfeifer**. That is the fixed cost.

Mr. **Wyden**. You compare it to being hooked up to cable television. On the local side, for local calls, this nontraffic sensitive matter suddenly seems to become sensitive and every time a local call is made, it adds costs to the local system.

What I would like to explore with you is if a long-distance call is made that doesn't add cost to the local system, how can we then say, how is it that the local network is sensitive to local calls but long-distance calls pass through without causing any additional costs? If we could get that on the table, we might know more about the company's position.

Mr. **Pfeifer**. When you make a local call, you pick up your phone, you are connected to the central office over the local loop, that is the line that goes from your house to the central office. That is a dedicated facility to you. That is a fixed cost. Depending on where you call then, in the Seattle or Portland you can call from the suburbs on one side of Portland or Seattle to the suburbs on the other side, and that goes through a series of switches and additional trunking that is traffic sensitive.

In other words, the more volume you have going from office to office, the more capacity you have to have in the switching network and the interoffice cable facilities. That is traffic sensitive. So the more usage you have locally, if you use your telephone twice as much as the average, you don't have to have two local loops to go into the central office, but you are using twice as much capacity in the local network.

With regard to long-distance, when you pick up the phone, you go from your house across the local loop, which has fixed a portion of the cost picked up by the long-distance carrier, go to the local central office and use the switch capacity, which incurs a cost to the local telephone company, and then you are switched to the long-distance carrier, either directly or through some other office.

So a long-distance call utilizes the fixed cost, the traffic sensitive costs, of the local network, and it also uses the long-distance facilities.

Mr. **Wyden**. I again must say to you that I am still somewhat confused on this point. To me, capacity is a fixed cost, and once it is built, the costs then become very different.

Mr. **Pfeifer**. No, it is not. An example, one of the problems is referred to as extended area service, taking Portland, it used to be a long-distance call to Gresham. In the case of Seattle, it would be a call from Seattle to Bellevue used to be a long-distance call, but as the community grew and became a common community, people worked and lived on one side or the other. There was a demand arising that this not be long-distance anymore. Why should you be able to call to the border at the local rate with no charge, but once it goes across the line, it becomes a long-distance call.

As the toll revenues grew and economies of scale contributed more to the subsidies, we were able to absorb those kinds of distances without increasing prices. But typically what happens in that situation is that you obviously lose all of the revenue that came from the long-distance part of the business that made a contribution to that toll pot, but the call capacity went up 300 percent.

You can't carry the same amount of capacity on the lines going from Seattle to Bellevue or Portland to Gresham when you have got an increase of 300 percent than you could originally, so you have to add more trunking and have more switches. That drives up the cost of the local switch network and eliminates the revenue in that case.

Mr. **Wyden**. I have a feeling you have lost a lot of people, certainly me, and I have been trying to follow this. Dr. Mitchell said that once the capacity is built, a call during off-peak hours costs very little.

Mr. **Pfeifer**. Off-peak, yes, but the question is, do you want to have a system where during the busy hour, nobody can get a line? That is part of what Perry is talking about in degradation of service. We are expected to put the call through at any time during the day. If you expect to have a time during the day when calls get bogged down but you can call later in the evening, you can have less capacity, but if you want to call 24 hours a day, including peak periods, there is an impact of usage on the investment and, therefore, on the cost.

Mr. **Wyden**. I want to move on. The task force is willing to work with the company on this point. I still come back to what strikes me as something either I don't understand or can't be adequately explained——

Mr. **Swisher**. Could I offer something on that point?

Mr. **Wyden**. Sure.

Mr. **Swisher**. In Idaho, we declined to pattern the FCC system of access charges. We have even asked the Ma Bell to give us a tariff for that person, that user who chooses not to impose himself or herself as a burden on the whole telecommunications network of the country and isn't going to use the long-distance system, and give us a lower rate for that person. We are trying to deliver a message about the service.

But, more importantly, in the calculation of access, in the calculation of access charges, we require in the area where we have jurisdiction, we require payment toward the nontraffic sensitive part of the system, because this fiction of separation was a bookkeeping fiction. It is very similar to the embedded direct analysis system that AT&T used for very good bookkeeping purposes.

But once divestiture occurred, they believed their own myth and they are running 5 and 6 months behind in their ability to provide new service, because it was a fallacy. They were entitled to use it for breakout purposes, but the truth of the matter is that the system is so integrated, the sorting out of NTS and traffic sensitive has its purpose for rhetorical forums like this one, but in the real world there is no sorting it out. Cost causers, as we now call people, once they come on the system, start to produce revenues and the integration is endless and infinite.

All I am saying is we do not accept the FCC premise which was supportive of the Bell posture on divestiture. We look at our experience in deregulating other utilities and say you can divest if you want to, but you can't dismember an integrated system with respect to costs. We don't think FCC has to do it, and we are sorry the ledger costs are now being treated as if they are three-dimentional realities. They are not.

Mr. **Wyden**. I appreciate that thought. We will work with you more. It is difficult for me to understand how you can ask for measured services and access charges at the same time, access charges because things are fixed, measured service, because things aren't fixed. But I will be glad to talk about that more later.

You mentioned the point about subsidizing wealthy people and retirement homes and every Member of Congress doesn't want to do that. Is there any other way to get to the universal service goal, in your view, besides going to phone stamps, which we have talked about, and moving toward what I think would be a two-class communications system?

I don't think your company wants that, and people on this task force don't want subsidies for people high in the California mountains. Are there other alternatives? My background with the elderly suggests that there is no way on Earth something like phone stamps can work.

Mr. **Pfeifer**. Directory assistance is an example. One of the concerns with directory assistance charging was how do blind people deal with that, who are unable to use the directory? We said anybody that has that kind of a problem have a certificate for a form filled out and send it to us, and we will take that charge off their account.

We proposed legislation in the last session of Congress that essentially would have provided the same mechanism for people who have a fixed need for a limited cost telephone service and, of course, it was not successful. But it is our position that that kind of thing can be done, it ought to be administered at the State level, so that the State regulator has some control of the process. But we believe that the truly needy are relatively small in number that can be dealt with positively and make sure that there is universal service.

But, again, when you come up with a universal answer and everybody gets a benefit, that isn't going to fly over time.

Mr. **Wyden**. You talk about the truly needy, and I saw a lot of truly needy in my district lined up to get at the community telephone last Saturday. I think we have more work to do. If you have approaches that won't get us back into this welfare ball game, I think you are going to be met with great receptiveness.

I note with interest your discussion of various tax votes that have been held in the U.S. Congress. I was just very sorry to see that your company hadn't backed the Deficit Reduction Act, because in Oregon, if we hadn't gotten that Deficit Reduction Act, our veterans wouldn't have been able to get any loans to have homes and if you can't have a home, you can't have a phone.

Mr. **Pfeifer**. Yes, you can. You can have cellular in your car.

Mr. **Wyden**. Thank you for some valuable comments. I think I would like to turn next to Perry Swisher. Perry, how do you evaluate PNB's costs? We have had all this discussion about not really knowing what is out there and not getting the right information and that kind of thing. Are you all able to do this in a manner that you consider satisfactory? Are you getting enough information? Why don't you describe the process?

Mr. **Swisher**. I suspect each State does a version of what we do. Our major operating company in Idaho serves two-thirds of the people, Mountain Bell, under U.S. West. So we pay—that is to say the staff pays special attention to the numbers crunching with respect to cost allocations in dealing with that *Mountain Bell* case. It is the most complex case, affects the most people.

Then what you learn from that you apply with PNB, and Pacific Northwest Bell in the Idaho jurisdiction is relatively small. You look at their numbers as they come across the border from the Washington Utilities and Transportation Commission, and what the commissioners themselves, as regulators, do with all this technical data that accumulates in the hearing room is to sort it out, not on a cost-causer basis, not in that kind of allocation of costs among the classes, but in an effort to get to whatever will keep that company viable with respect to its return on its investment.

And as we go through this, if we do what the gentleman from Rand Corp. was just doing and we hang up there on a policy level, we are drowned by the numbers. The cases roll in fast enough that we can measure some of the results, see what has gone wrong and make corrections, and I think we are pretty responsive to interaction to try to cure things.

But what I want to say most strongly, when I have the opportunity to talk to Members of Congress, is that for God's sake don't let the ideology get in the way of the reality that the operating companies will not be viable. If you continue to accept the myth that toll is one universe and backbone to plant is another universe, if you accept that, you have already done the Balkanization. That is not acceptable; and in the attempt to get the costs, if you take an integrated system and you say does the foot subsidize the hand, does the arm subsidize the leg, you are becoming Byzantine, medieval, you ought to knock it off and it is only done to mislead you.

Mr. WYDEN. Dr. Mitchell, a public utility commissioner, in talking about measured service in Oregon talked about how under measured service people pay in accordance with their usage, and then talks about how this isn't any different from the way electricity and natural gas is priced.

My question to you, because you have obviously spent a lot of time looking at this area, How comparable are electric and natural gas service to telephone service? I ask the question because it is my understanding that there is a higher proportion of costs that are fixed in the telephone system than there is in the natural gas and electric area. I wondered if that is your analysis and if it is your analysis, what are the implications of this for an economic pricing system in the phone area?

Mr. MITCHELL. Thank you.

I think that is a particularly apt question. Fortunately, I have had some opportunity to study electricity pricing in some detail. There are important economic elements. Both electricity, gas and telephone utilities have very high capital costs per unit of service. But the details of the cost structure are rather different. Electricity and natural gas consume resources as they are used at any time. With the exception of hydroelectricity, which is a case that we could discuss in some detail, electricity is generated by scarce fuels which have alternative uses and real values. So there is a cost that must be paid regardless of the hour it is used.

That is not the case for telephone communications service. Essentially all the costs are either totally fixed, overhead costs, or are capacity costs that are driven by maximum usage rates, and those maximums tend to occur for a few dozen hours in the entire year. At other hours of the year, that capacity is somewhat in excess. More telephone calls could be made at those times without consuming any important amount of additional resources.

That fundamental difference means the difference between peak and off-peak rates is going to be far more extreme in the telephone industry than in electricity or natural gas.

Mr. WYDEN. The only other question is for you, Mr. Branstetter. One of the reasons that there was such an outcry about measured service in Oregon is that our statewide newspaper, the Oregonian, did a big analysis. Essentially, they had a table for California and a table for Oregon for various kinds of phone services and came to the conclusion that Oregon is paying a lot more than California. Basically, what the table showed was in the vicinity of 50 percent more under this proposal.

Are we doing something wrong? When I looked at your figures my impression was, if I went out to the business persons in my district, they would look at your costs and they would say, "Boy, this doesn't look bad at all. This looks pretty promising," and yet when the proposal came up in Oregon, we heard from all the groups of small business people like realtors, insurers, homebuilders, people who use the phone continually, we heard a tremendous concern.

I would ask, how do you all seem to do it right, or are we doing something wrong, or what counsel would you have to us as we proceed even in Oregon during this year to look at the best ways to keep the bills down?

Mr. **Branstetter**. I haven't seen the table in the Oregonian. You have to recognize that our analysis is 100 percent of the business customer market. It is not the high user necessarily, it is not the vocal, it is not the individual who is sensitive to these kinds of issues, it is the silent majority in many cases, and that is why I think our story is fairly powerful, it shows the facts in an accurate way once the measured service is provided.

I can't evaluate what kind of study was put together to support the information that was presented in Oregon. There are many ways to produce that, what kind of groups you pull the information from can influence it, but I would assume that you are obviously hearing from the majority of the people who are high users and who are concerned about the fact that they are going to have to pay more for telephone service than they have in the past.

There is no question that some people pay a lot more. The question of accepting pay for what you use has been pushed so hard in California for so many years——

Mr. **Wyden**. What about discrepancies like the hunting charges? You heard the first panel tick off two or three things.

Mr. **Branstetter**. The issue of cross-subsidization we keep coming back to. The whole rate structure in the predivested world was a social-based rate structure. Costs were covered, identified, but the costs were not borne by the cost-causer; they were borne by a combination of political and social values that the regulators and the telephone company and the politicians decided was appropriate.

So we had that history and foundation that we have had to transition out of, and we have charged people for services in many cases based on that political and social philosophy, who is willing to pay, who will pay with the minimum amount of reaction—this is an oversimplification of the problem, but those kinds of policies over the years were the ones that were directing the rates that we charged end users. Some costs were recovered, some were not.

Mr. **Wyden**. I still don't see how economic and social philosophy, albeit murky can be responsible for such a wide differential in hunting charges. We had our business people come up and talk about a huge differential between the cost of the hunting and the price.

I might also add something you don't know. Our public utility commissioner gave a major address a few weeks ago on Oregon, one of our major civic groups, and said, "Well, we did have to price it higher than we probably should have because we didn't have all the information, so we started initially with a higher price, and we would bump it down as we got going."

Mr. **Branstetter**. You start from a foundation of so much cost and you have to recover the cost. You can spread it among individual items, like hunting, or any service we provide, and that decision of how you spread it is a complex social/political issue, so the question of what the market will bear comes into it, and in many cases that has driven some of our prices.

The point is we have analogies in California where we charged 500 percent more than the cost for certain issues because it is appropriate in the environment we are in. I can comment on the fact we have analogies, but I can't defend hunting in this case.

Mr. **Wyden**. If you could furnish to the committee the name of the people at your place who were involved in construction, it would be helpful and particularly the hunting charge, because I think we get back to specific concerns that the small business people raised this morning, get answers to those, and we are on our way to reconciling our differences.

Mr. **Swisher**. With respect to that, in California, could I suggest that the committee should also on implementation measures get in touch with the PUC head staffer from California?

Mr. **Wyden**. Good point. We will do that. If we could have that from you.

Gene, a quick comment. I haven't recognized my colleague, Mr. Skelton, here.

Mr. **Pfeifer**. With regard to the question of the California rate versus the Portland rate, there is a simple answer to that. You have to deal with apples and apples and oranges and oranges. In the price comparison, you are dealing with apples and oranges. If you go to California and you have telephone service, you have a very limited local exchange fee dialing area, and when you dial outside that area, you pay message units, so many cents per unit times the minutes and the distance. It is kind of a halfway long-distance charge.

If you make a comparable analysis, one on one, you will find the rates in California are equivalent to Seattle or Portland, or whatever, and that is a matter of record filed with the FCC in a study completed for them and we will have a copy of that prepared and sent to you.

Mr. **Wyden**. We will be here forever.

The way I understand it, if you add it altogether, it does become apples and apples, the Oregon rate is significantly higher than anything being talked about in California. I have never heard the California public utility commissioner give a speech like I heard in Oregon a few weeks ago, where the PUC commissioner said, "We have to set the rate a lot higher than we probably needed to because we didn't know what all the costs were going to be," and we will come back later on—even that kind of business decision, we have to make a projection, could have been handled better.

You take the high projection and the low, and maybe you go with the middle projection. But I think you see with statements like that why there was so much opposition from the Oregon business people.

Mr. **Pfeifer**. It is on file that they were virtually the same, and we will make a copy available.

Mr. **Wyden**. Mr. Skelton?

Mr. Skelton. Mr. Pfeifer, you commented that the fight to keep universal telephone service is patently ludicrous. I find that statement rather ludicrous. I am concerned about it. From all I have heard today, I was hoping you would be listening to the same thing as I. You heard the testimony by the young lady that if telephone charges go up $12 a month, 66 percent of the senior citizens would drop off the telephone system?

Mr. Pfeifer. Our studies and the studies of the Washington Utilities Transportation Commission would not support that conclusion.

Mr. Skelton. You think everybody would hang in there?

Mr. Pfeifer. That is correct.

Mr. Skelton. You think that bypassing the public system which would peal businesses out of the toll universal telephone system, causing additional increases for those remaining, would have no effect; is that correct?

Mr. Pfeifer. The bypass problem would have an effect.

Mr. Skelton. So that would be a threat to the universal telephone system?

Mr. Pfeifer. Yes, and that is why the access charges must go into place, or something comparable, to avoid triggering the bypass problem.

Mr. Skelton. So what you said, ludicrous, is not a correct statement, is it?

Mr. Pfeifer. What I said was the concern, in face of what the history has been in the telephone business and what we think we do, that the concern is ludicrous.

Mr. Skelton. That is not what you said. The record will speak for itself.

Thank you very much.

Mr. Wyden. Thank you, Mr. Skelton, and panelists. We will certainly be working with you gentlemen in the days ahead. Thank you.

Let's have all five of our remaining panel members come forward, and we will have statements together and questions together. Mr. David King, president, United Telephone Co. of the Northwest, Hood River, OR, Oregon Independent Telephone Association; Mr. Kenneth Sandner, manager, Stayton Cooperative Telephone Co., Stayton, OR, Oregon Independent Telephone Association; Mr. Jon Ericson, vice president and general manager, Peninsula Telecommunications, Inc., Olympia, WA; Mr. Michael Woody, director of telecommunications, department of general administration, State of Washington, Olympia, WA; Mr. Gary Conkling, Tektronix Inc., Beaverton, OR.

Let's begin with David King of United Telephone Co. of the Northwest.

TESTIMONY OF DAVID D. KING, PRESIDENT, UNITED TELEPHONE CO. OF THE NORTHWEST

Mr. King. Thank you.

My name is Dave King, president of the United Telephone Co. of the Northwest, serving Oregon and Washington. In the State of Oregon, we serve about 40,000 customers, but I am here also as vice president of the Oregon Independent Telephone Association and comments will be made primarily in that vein.

One of the things that many times is overlooked is the independents served in the State of Oregon, 50 percent of the land area, 360,000 customers and approximately 30 percent of the total subscribers, and it seems as though most people direct all their concerns toward Pacific Northwest Bell. We want to be on record to say that we, from the beginning, have been very concerned about universal service, continue to be concerned about universal service.

I think it is fair to say that the industry didn't volunteer for deregulation, but now that we are there, we are trying to assess the realities of where we are and look at the options and things that we can do as far as the future. We think it is important to keep an open view of what is happening in the industry and not get tied up in any particular solution.

I think that what we are going to have to do is work our way through this thing hand over hand and at each junction hopefully have the option to be able to adjust. Within our association, I think there is quite a bit of agreement between all of us, big and small, about the problems that we have to deal with.

There are some differences in the solutions that we think are appropriate, but we do have to deal with those problems of de-averaging of toll, lifeline services, local measured service, available pricing option, REA funding.

Equal access is an issue we haven't talked much about, but it is a costly issue to us that we have to deal with. Just the cost of doing business has changed significantly. Most of us had two revenue sources: Our customer and then the settlement process with Pacific Northwest Bell. Now my company has 11 revenue sources, so we have a little different process, and all the other small companies have the same problems.

The FCC has left, even though there isn't toll agreement between all of us that the FCC is the proper solution, I think most feel that we have to begin to head in the direction of moving some of those costs to the subscriber and the end user.

The argument is how much, do most of it, all, or half or a third? I don't know. I think there is general feeling we should begin to move it, and as we go through the process, begin to further test the validity of those kinds of analysis which we haven't had that kind of experience. I think there is enough experience in the industry where we have had significant rate increases over a number of years that the penetration hasn't significantly changed.

I can assure you that in Oregon and Washington we have in place a vehicle that will allow us to better test what actually is happening relative to people who leave the network and why they leave the network because we asked them the question. We tried to determine why they left, and was it a cost consideration to the access charge?

The issue of allocation of cost, we can go on and on and the economists will never totally agree on how to allocate the costs. We in the industry know our investments and costs. It is not like we are dealing with numbers that keep moving around. The issue is: Where do you get it from, does it come from long-distance or local?

If you believe that bypass is a problem in our industry, then you have to move toward cost-based pricing. If you believe it is not a problem in our industry, then just load the cost wherever it is convenient, whether it be hunting, or whatever.

Our industry has never had rates based on the overall costs. I think we all know that. We have dealt with residual pricing for years, where we got the revenues from long-distance, from other local sources, whatever was left was that revenue which we had to recover from the local subscriber.

I think we are seeing, I think the State commissions and the State legislative bodies are becoming very interested, very knowledgeable, much more responsive to trying to get in and understand the issues, as well as probably this committee today better understands them than they did 2 years ago.

So we would encourage that we be allowed to continue to try and resolve these problems, move toward moving the costs back to where they belong and create a flexibility that allows for alternate pricing and any other process.

Thank you.

Mr. WYDEN. Thank you.

[Mr. King's prepared statement follows:]

PREPARED STATEMENT OF DAVID D. KING, PRESIDENT, UNITED TELEPHONE CO. OF THE NORTHWEST

My name is Dave King, President of the United Telephone Company of the Northwest, serving Oregon and Washington. In the State of Oregon we serve approximately 40,000 customers. I am also here as Vice President of the Oregon Independent Telephone Association and comments will be made primarily in that vein.

One of the things that many times is overlooked is that the independents serve in the State of Oregon 50 percent of the land area, 360,000 customers or approximately 30 percent of the total subscribers, and it seems as though most people direct all their concerns toward Pacific Northwest Bell. We want to be on record to say that we, from the beginning, have been very concerned about universal service, continue to be concerned about universal service.

I think it is fair to say that the industry didn't volunteer for deregulation, but now that we are there, we are trying to assess the realities of where we are and look at the options and things that we can do as far as the future. We think it is important to keep an open view of what is happening in the industry and not get tied up in any particular solution. I think that what we are going to have to do is work our way through this thing hand over hand and, at each junction, hopefully have the option to be able to adjust. Within our association, there is quite a bit of agreement between all of us, big and small, about the problems that we have to deal with.

There are some differences in the solutions that we think are appropriate, but we do have to deal with the problems of de-averaging of toll, lifeline services, local measured service, availability of pricing options, REA funding.

Equal access is an issue we haven't talked much about, but it is a costly issue to us that we have to deal with this also. Just the cost of doing business has changed significantly. Most of us had two revenue sources: our customer, and then the settlement process with Pacific Northwest Bell. Now my company has 11 revenue sources, so we have a little different process, and all the other small companies have the same problems.

There is not total agreement among all of us that the FCC proposal is the proper solution. But most of us feel that we have to begin to head in the direction of moving some of the NTS costs to the end user or subscriber.

The argument is how much should it be - all, or half, or a third? I don't know. I think there is general feeling we should begin to move the NTS cost to the subscriber, and as we go forward, begin to further test the validity of our assumptions on bypass and universal service. On the question of price elasticity, there is enough experience in the industry where we have had significant rate increases over a number of years that the penetration hasn't significantly changed.

I can assure you that in Oregon and Washington, we have in place a vehicle that will allow us to better test what actually is happening relative to people who leave the network and why they leave the network because we asked them the question. We tried to determine why they left, and was it a cost consideration to the access charge?

The issue of allocation of cost, we can go on and on and the economists will never totally agree on how to allocate the costs. We in the industry know our investments and costs. It is not like we are dealing with numbers that keep moving around. The issue is: Who pays the NTS costs? Does it come from long-distance or local?

If you believe that bypass is a problem in our industry, then you have to move toward cost-based pricing. If you believe it is not a problem in our industry, then just load the cost wherever it is convenient and politically acceptable.

Our industry has never had rates based on the overall costs. I think we all know that. We have dealt with residual pricing for years, where we got the revenues from long-distance, from other local sources; whatever was left was that revenue which we had to recover from the local subscriber.

I think we are seeing, I think the state Commissions and the state legislative bodies are becoming very interested, very knowledgeable, much more responsive to trying to get in and understand the issues, as well as probably this committee today better understands them than they did two years ago.

So we would encourage that we be allowed to continue to try and resolve these problems, move toward moving the costs back to where they belong and create a flexibility that allows for alternate pricing.

Thank you.

Mr. WYDEN. Mr. Sandner.

TESTIMONY OF KENNETH E. SANDNER, MANAGER, STAYTON COOPERATIVE TELEPHONE CO.

Mr. SANDNER. Thank you. My name is Ken Sandner, president of the Oregon Independent Telephone Association, manager of Stayton Cooperative Telephone Co., Stayton, OR. We serve 3,700 customers in Stayton and the surrounding area. Due to the divestiture of AT&T and the FCC's access order, the telephone industry, certainly the smaller companies, are in turmoil. We have no long-term rules right now to follow. We are not sure what is coming down the road or what rules we are going to have to abide by 5 years from now. How can we make a long-term capital investment when really there is some doubt about where we are right today?

For example, the National Exchange Carriers Association seems to have a revenue shortfall and they are investigating to try to find out why, and I am sure they will. The FCC is toying with our rate of return. We don't know where that is going to end up. Just the cost of preparing for these changes is tremendous without our even considering ongoing costs. In our company we have isolated some of these costs.

I am certain we haven't picked up all of them, but the costs that we have been able to isolate amount to over $150,000 for 1 year. Now, this hasn't bought anything for the customer, no new equipment. It has caused them some confusion. But that is $40.50 a customer in 1 year. Now, if we take this $40.50 times the 111 million telephone users in the United States, we come up with $4.5 billion. I wonder if this tells us that the Justice Department and the FCC acted in the public interest.

Now let us look at some of the ongoing costs to our customers. We are concerned with who should pay the cost of non-traffic-sensitive plant, the wires from the central office to the customer's premises. In our company's case this NTS plant is used 65 percent of the time for long distance, and I have some charts that I would like to point out things on.

This is our telephone company, Stayton Cooperative Telephone Co. In 1983 the local customer paid 23 percent, the local rates picked up 23 percent of the NTS cost, or $3.77 per month. Interstate toll picked up 32 percent, intrastate toll 45 percent, and we had a total rate charged to the customer of $8.30, including $4.53 of the traffic-sensitive cost of providing that local service.

Now, as I mentioned, our local loop, NTS plant was used 65 percent of the time for long distance. Now, this shows how it would be spread if it was based on the actual usage, so you can see that we were getting a small subsidy. We can't argue that. If we were put back on actual use without a susidy and the long-distance carriers were paying the fair share for their use of the local loop, this is where we feel we would have been, 35 percent to the local rates, the local customer, or $5.75, and 38 percent to interstate and 27 percent to intrastate.

Now, that would have changed our rate of return from $8.30 to $10.25 per month. Now, this is an average taking our overall rates and coming up with an average monthly rate. Now, the original plan with FCC, as I understand it, in about 1989, the local customer would pick up 100 percent of the cost of that local loop.

That would put the local rates at $20.96 per month. That doesn't seem like, to some of you that live in the cities perhaps, like a high monthly rate, but you have to remember that our customers, without paying a long-distance charge, can reach less than 10,000 telephones, and of course you know for your rates in Washington, DC, how many telephones you can reach for the local rate, so that is something that you have to take into consideration.

Mr. **Wyden**. I am glad you said Washington, DC, that that counted too. I wasn't sure that that was a relevant barometer.

Mr. **Sandner**. Thank you, sir.

The Independent Telephone Association is endorsing a compromise plan which would allot 50 percent of the NTS costs to the local customer and 25 percent to interstate toll, 25 percent to intrastate toll. This would put our rates in Stayton at approximately $12.75. Of course, that doesn't account for inflation and other things that might come up.

I would like to say that Stayton Cooperative Telephone Co. is not a high-cost company. We are an average-cost company. Here is an example of a high-cost company. This is Home Telephone Co. in Condon, OR. This is what was happening in 1983. Forty-seven percent of their cost was paid by intrastate toll, 34 percent by interstate toll, and $8.09 cents by local.

If they had to pick up 100 percent of their non-sensitive-traffic costs, $45.78 plus $1.01 for traffic-sensitive costs, they would have $46.79 for the local rate. Under the compromise plan, they would pay $23.89. We also propose a high-cost fund for customers in areas like this that would help reduce this rate for this company. We really object to the FCC's plan of putting this whole non-traffic-sensitive cost on the local rates. This would leave the residential and small business customers subsidizing the Fortune 500 companies.

About 12 percent of our customers make no long-distance calls. Why should they pay an access charge to the long-distance network? And I would like to point out that while the burden of these increases is greater on the rural customers, the customers in the cities are certainly not exempt.

Look at what has already happened to Pacific Northwest Bell customers in Oregon. One party resident's rates went from $7.50 per month in 1981, and that included the access line, the inside wiring, the telephone and the maintenance on all of those, to over $12 just for the access line, and now a telephone is extra, and inside wiring maintenance is extra, and if you add the cost of the telephone and maintenance to that $12 rate, that is a 100-percent increase in local rates, and I think that is just the beginning of what is going to happen.

We are being told, sure, your local rates are going up, but long-distance rates will go down. Well, what about the 12 percent that make no long-distance calls? While I agree that long-distance rates may go down on some high-traffic routes, I believe we will see just the opposite on low-traffic routes in rural areas, thus leaving rural customers with higher local rates and higher long-distance charges.

Bypass has been brought up several times and I would like to say just a little bit on that.

Mr. **Wyden**. I only interrupt you by way of saying that I suspect now we are going to start running the clock. If you could highlight your concerns, that would be great.

Mr. **Sandner**. Just a couple minutes here. It seems that Southwestern Bell is so concerned about bypass that they asked the State commissions to outlaw bypass. We as independent telephone companies are also very concerned about bypass. We don't believe the way to control bypass is to place an undue burden on our customers by high access charges to keep the interexchange access charges down.

We believe, as proposed in recent legislation, that we should place a charge on those that bypass the network to make bypass less attractive. Actually, our biggest fear of bypass is from other exchange carriers; namely, the Bell operating companies and AT&T. Perhaps they should be restricted from bypassing us.

Thank you very much.

[Mr. Sandner's prepared statement follows:]

PREPARED STATEMENT OF KENNETH E. SANDNER, MANAGER, STAYTON COOPERATIVE TELEPHONE CO.

My name is Kenneth Sandner. I am President of the Oregon Independent Telephone Association ("OITA") and Manager of the Stayton Cooperative Telephone Company ("Stayton"). Accompanying me is Mr. David D. King. Mr. King is the present Vice-President of OITA and President of United Telephone Company of the Northwest ("United").

Mr. King and I are here today as representatives of the Oregon Independent Telephone Association ("OITA"). OITA consists of 30 independent telephone companies dedicated to modern and efficient telephone service at reasonable prices (Exhibit #1). The member companies serve approximately 50% of the state's land area and more than 360,000 or 29% of all access lines in Oregon State (Exhibit 2). These areas are geographically diverse and primarily rural.

We believe that Stayton and United are representative of most of these companies. Stayton services one exchange with 4,004 access lines. United serves 30 exchanges. Its largest exchange has 6,710 access lines and its smallest exchange has 41 access lines. Eighteen of its exchanges have less than 1,000 access lines.

Our purpose today is to address the questions set forth in your letter of invitation addressed to Mr. Maury Astley, Executive Vice President of OITA. Mr. King and I wish to assure you that OITA and our companies share the Task Force's concern that universal telephone service be preserved and our responses are deeply colored by that concern.

CHANGES IN THE TELECOMMUNICATIONS INDUSTRY

As this Committee is well aware, the telephone industry has experienced unprecedented changes during the past few years. Starting in 1958, the seeds of competition were introduced into an industry which had previously been conducted on a monopoly basis. Over the next two decades a succession of Federal Communications Commission ("FCC") and court decisions opened almost all facets of our industry to competition. With the break up of the Bell System, the rate of change increased. Today we are in an environment which is moving toward cost based pricing. The FCC speaks of the customer/end-user being responsible for the costs associated with his/her local loop. Obviously these changes impacted all telephone companies--small and large.

The greatest single change has been an end to the traditional revenue settlements process. Historically all toll revenues were pooled, and then the companies recovered their expenses and a particular rate of return on their investment. This process has been replaced by more diverse revenue sources. Today, at the interstate level a system of access charges, which are paid by interexchange carriers for use of a local exchange company's facilities, is employed. In addition, there is the recently implemented $6 charge on multiline business customers. These revenue sources serve to replace the traditional sources of interstate revenue for exchange companies.

In past years, the intrastate toll settlement process in Oregon was similar to that employed at the interstate level. However, with the advent of access charges, that process was abandoned and a new system of revenue sources was implemented. Today, in Oregon, carriers' access charges for use of local exchange company facilities are in place and toll surcharges have been placed on toll carriers and toll customers/users. This mix is a significant departure from recent past practices.

Accompanying the changes in the traditional revenue settlements process has been an increase in costs to administer these changes. No longer is one entity, AT&T, the center for the management of the interstate revenue poll process and the development and administration of tariffs which addressed all interstate carriage of traffic. Rather, companies are being required to develop specialized billing procedures for access charges and to acquaint themselves with new administrative agencies, such as the National Exchange Carriers Association ("NECA"). In this new environment, NECA is obligated to gather information and data to aid the industry through this transition. While their task is praiseworthy and valuable, it has created additional work requirements for all companies.

In addition, each company has been required to develop or concur in a completely new set of tariffs at both the interstate and intrastate levels. These tariffs have generally averaged 600-700 pages in length. For the small companies, with limited numbers of employees, this has necessitated a greater reliance on outside accounting and consulting services. For a small company with high costs, it is likely that it will not be able to absorb these increased administrative expenses or a revenue shortfall associated with the new revenue mix as easily as a larger company.

IMPACT OF CHANGE ON EXISTING RATES

Telephone companies, small and large, will need to raise their rates as a result of the changes which are occurring in the industry. The increase will vary from company to company depending on the investment they have in their non-traffic sensitive ("NTS") plant, which includes Customer Premises Equipment, i.e., the telephone instrument, the inside wire at the customer's location, the outside cable pair from the customer's location to the telephone company's central office switching facilities as well as part of the central office (Exhibit 3), and depending on the plan which is finally adopted by the FCC and the local state Commission. At the same time, the customers using the interstate toll network may realize a general decrease in toll charges. The first example of this is the recent 6.1% decrease in interstate toll rates. It is also likely that the most heavily used portions of the intrastate network will experience toll rate decreases. However, these benefits will not accrue to all of the telephone subscribers in the state. Many rural subscribers have calling patterns which make use of high cost, short haul, low density intrastate routes. For many of these subscribers, it is very likely that they will not see any decrease in toll charges and may actually experience increases in toll rates.

Assuming the existing FCC plan is allowed to go into effect, the present monthly charge of up to $6 for multiline business customers would be continued. In the meantime, in 1985, residential customers would begin to pay an additional $2 to cover that portion of their NTS costs allocated to the interstate jurisdiction. This figure is expected to increase over the remainder of the decade. If the state employed a similar plan, including mirrored rates and a high cost factor, then that portion of a business or residential customers NTS plant assigned to the intrastate jurisdiction would be recovered in a similar manner. However, as we previously noted, not all customers would experience the same increases because some telephone companies have NTS costs which are relatively low.

Obviously, high cost companies will need some revenue support in order to provide reasonably priced service to their customers. In response to this concern, it is our understanding that the Federal-State Joint Board in FCC Docket No. 80-286 is reexamining the high cost factor to insure that no customer's monthly rate for his/her NTS plant will exceed 135% to 156% of the national average. To the extent that a company's costs exceed that amount then the company would receive the additional funds from a charge levied on interexchange carriers. This would establish a maximum rate that any subscriber would pay in the United States.

While small companies and large companies in Oregon endorse the concept of allocating NTS plant to the interstate and intrastate jurisdictions, it is important to note that they are not in total agreement as to the manner for recovery of those costs. This healthy divergence of opinion within our association is driven by each particular company's feelings on bypass. The state's local exchange carriers view bypass of their companies or of any other exchange carrier as a threat to the network and ultimately to their own company. Many of the smaller companies are not comfortable with the FCC proposal which was previously discussed. Rather, they propose that part of the NTS costs allocated to the interstate and intrastate jurisdictions be recovered from charges to the interexchange carriers. In order to prevent an exodus from the existing network, these companies further propose that a special charge be assessed on entities which bypass the existing network.

However, other companies subscribe to the existing FCC plan which places approximately $1 Billion in charges on the interexchange carriers for support of high cost companies. It is possible that a plan increasing the charge to carriers to an amount slightly greater than the FCC plan, for the benefit of high cost companies, could be devised without over-loading the carriers and increasing the risk of bypass but it is not known how much that charge could be increased. Simply put, these local carriers do not believe high volume toll users can be required to subsidize other subscribers in a competitive environment.

SPECIAL PROBLEMS

The members of OITA, small and large, have devoted themselves to the improvement of the telephone network for the benefit of their customers. As noted, the members are interested in making quality service available to all their customers at a reasonable price. Recognizing the changes that are occurring and the pressures these changes will place on local rates and thus certain classes of customers, OITA intends to closely monitor and support the need for "lifeline" service for those economically disadvantaged customers who might leave the network due to rate increases.

While committed to the concept of universal service, OITA members do not propose to usurp the jurisdiction of the various social service agencies in determining who should participate in such a program; and while the OITA members do not wish to be involved in administering such a program, OITA would support a mechanism which targets specific benefits for specific individuals to aid them in paying for and maintaining telephone service. Several funding alternatives are available for such a program including the use of some or all existing telephone taxes or possibly a monthly charge on all telephone subscribers in the state. While such an approach could generate the funds to aid needy individuals, and while OITA will be supportive of lifeline legislation, the ultimate decision rests with the state legislature.

Another concern to OITA members is the growth and use of Extended Area Service ("EAS"). One of the primary reasons for the establishment of EAS calling areas was to allow exchanges within the same area, and which had a community of interest, the ability to make unlimited calls to another exchange for a flat rate fee. This service eliminated short haul toll between these points and was more economical for the subscribers. Although the cost of providing the service was spread to all consumers in the EAS area, it was a service which did not cover its existing costs and was subsidized by other services. With the introduction of competition into our industry and the move to cost based pricing, EAS has become a greater burden on companies due to the disappearance of excess revenue to subsidize other services. This has been compounded by the emergence of WATS resellers within EAS areas. Their presence extends the original purpose of EAS as a substitute for short haul toll to a staging base for long haul transmission. Depending on the practices employed by the reseller, existing trunk capacities can become overtaxed while others experience diminished use. To the extent that additional plant must be added or old plant is abandoned, the burden falls on local rate payers. We do not feel this is appropriate. The monopoly services which once supported EAS are gone or are disappearing. The WATS reseller is an entrepreneur who places certain demands on a system and as a consequence must assume certain responsibilities. We would propose that EAS service be measured and optional. While this is a regulatory matter, OITA realizes it will generate a great deal of political debate. However, when one considers the cost of additional EAS trunking caused by and for the benefit of a few, it only makes sense that a system of measured and optional service be introduced so that resellers can bear their proportionate share of the costs.

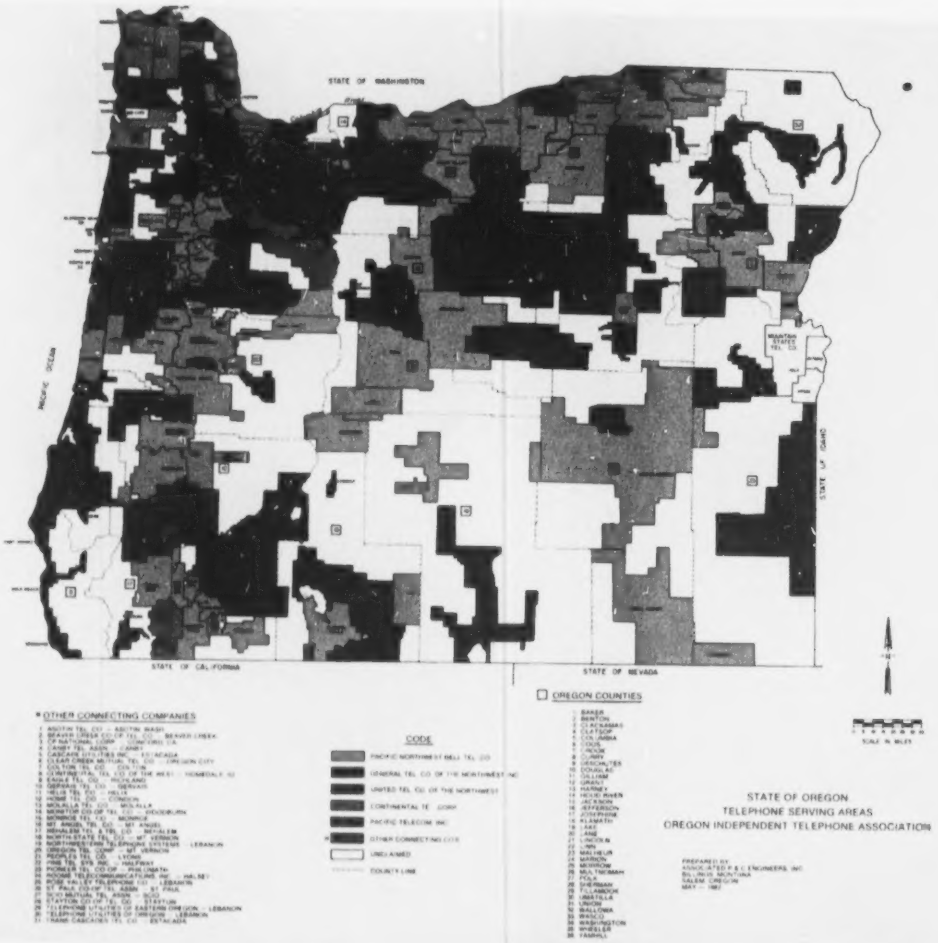
OITA, Mr. King and I thank you for the opportunity to appear before the Task Force today and we will willingly be of service to you in future matters regarding telephone service.

Kenneth E. Sandner
Manager
Stayton Cooperative Telephone Company
P.O. Box 477
Stayton, Oregon 97383
(503) 769-2121

David D. King
President
United Telephone Company
of the Northwest
601 State Street
Hood River, Oregon 97031
(503) 336-0222

8

EXHIBIT 1


STATE OF WASHINGTON
STATE OF IDAHO
STATE OF NEVADA
STATE OF CALIFORNIA
PACIFIC OCEAN
MOUNTAIN STATES TEL CO
N
SCALE IN MILES
● OTHER CONNECTING COMPANIES
1 ASOTIN TEL CO — ASOTIN WASH
2 BEAVER CREEK CO-OP TEL CO — BEAVER CREEK
3 CP NATIONAL CORP — CONCORD CA
4 CANBY TEL ASSN — CANBY
5 CASCADE UTILITIES INC — ESTACADA
6 CLEAR CREEK MUTUAL TEL CO — OREGON CITY
7 COLTON TEL CO — COLTON
8 CONTINENTAL TEL CO OF THE WEST — HOMEDALE ID
9 EAGLE TEL CO — RICHLAND
10 GERVAIS TEL CO — GERVAIS
11 HELIX TEL CO — HELIX
12 HOME TEL CO — CONDON
13 MOLALLA TEL CO — MOLALLA
14 MONITOR CO-OP TEL CO — WOODBURN
15 MONROE TEL CO — MONROE
16 MT ANGEL TEL CO — MT ANGEL
17 NEHALEM TEL & TEL CO — NEHALEM
18 NORTH-STATE TEL CO — MT VERNON
19 NORTHWESTERN TELEPHONE SYSTEMS — LEBANON
20 OREGON TEL CORP — MT VERNON
21 PEOPLES TEL CO — LYONS
22 PINE TEL SYS INC — HALFWAY
23 PIONEER TEL CO-OP — PHILOMATH
24 ROOME TELECOMMUNICATIONS INC — HALSEY
25 ROSE VALLEY TELEPHONE CO — LEBANON
26 ST PAUL CO-OP TEL ASSN — ST PAUL
27 SCIO MUTUAL TEL ASSN — SCIO
28 STAYTON CO-OP TEL CO — STAYTON
29 TELEPHONE UTILITIES OF EASTERN OREGON — LEBANON
30 TELEPHONE UTILITIES OF OREGON — LEBANON
31 TRANS-CASCADES TEL CO — ESTACADA
CODE
PACIFIC NORTHWEST BELL TEL CO
GENERAL TEL CO OF THE NORTHWEST INC
UNITED TEL CO OF THE NORTHWEST
CONTINENTAL TEL CORP
PACIFIC TELECOM INC
● OTHER CONNECTING COS
UNCLAIMED
COUNTY LINE
☐ OREGON COUNTIES
1 BAKER
2 BENTON
3 CLACKAMAS
4 CLATSOP
5 COLUMBIA
6 COOS
7 CROOK
8 CURRY
9 DESCHUTES
10 DOUGLAS
11 GILLIAM
12 GRANT
13 HARNEY
14 HOOD RIVER
15 JACKSON
16 JEFFERSON
17 JOSEPHINE
18 KLAMATH
19 LAKE
20 LANE
21 LINCOLN
22 LINN
23 MALHEUR
24 MARION
25 MORROW
26 MULTNOMAH
27 POLK
28 SHERMAN
29 TILLAMOOK
30 UMATILLA
31 UNION
32 WALLOWA
33 WASCO
34 WASHINGTON
35 WHEELER
36 YAMHILL

STATE OF OREGON
TELEPHONE SERVING AREAS
OREGON INDEPENDENT TELEPHONE ASSOCIATION

PREPARED BY
ASSOCIATED P & C ENGINEERS INC
BILLINGS MONTANA
SALEM OREGON
MAY — 1982

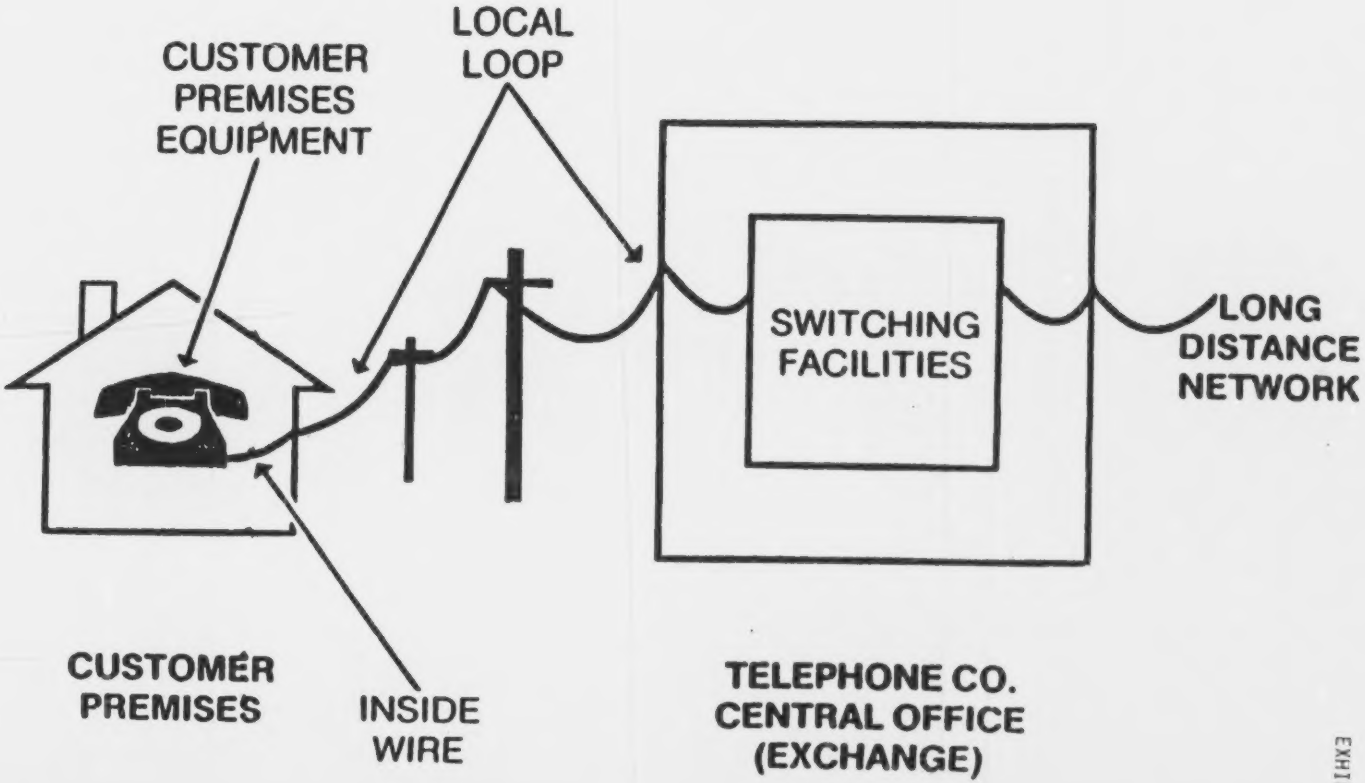
EXHIBIT 2

OREGON STATE TELEPHONE COMPANIES

Company	Access Lines
Asotin Telephone Company	85
Beaver Creek Cooperative Telephone Company	2,866
Canby Telephone Association	6,435
Cascade Utilities, Inc.	6,614
Clear Creek Mutual Telephone Company	2,413
Colton Telephone Company	861
Continental Telephone Company of the Northwest	19,102
Continental Telephone Company of the West	538
CP National	9,447
Eagle Telephone System	333
General Telephone Company of the Northwest, Inc.	214,930
Gervais Telephone Company	665
Helix Telephone Company	232
Home Telephone Company	582
Molalla Telephone Company	3,908
Monitor Cooperative Telephone Company	501
Monroe Telephone Company	693
Mt. Angel Telephone Company	1,256
Nehalem Telephone & Telegraph Co.	1,554
North-State Telephone Company	422
Oregon Telephone Corporation	1,388
Pacific Northwest Bell	904,587
Pacific Telecom, Inc.	33,851
People's Telephone Company	1,000
Pine Telephone System, Inc.	657
Pioneer Telephone Cooperative	8,952
Roome Telecommunications, Inc.	530
St. Paul Cooperative Telephone Association	450
Scio Mutual Telephone Association	1,309
Stayton Cooperative Telephone Company	4,004
Trans-Cascade Telephone Company	154
United Telephone Company of the Northwest	42,019

EXHIBIT 3

JOINTLY USED, OR COMMON, TELEPHONE FACILITIES



CUSTOMER PREMISES EQUIPMENT

LOCAL LOOP

SWITCHING FACILITIES

LONG DISTANCE NETWORK

CUSTOMER PREMISES

INSIDE WIRE

TELEPHONE CO.
CENTRAL OFFICE
(EXCHANGE)

Mr. WYDEN. Ken, thank you, and I know we will have some questions. I want to ask some things about your table.

Mr. Ericson, please proceed. I know Al wishes he could be here for your testimony.

TESTIMONY OF JON C. ERICSON, MEMBER, WASHINGTON INDEPENDENT TELEPHONE ASSOCIATION

Mr. ERICSON. I don't think he really does; he has heard this 10 times.

My name is Jon Ericson, a member of the Washington Independent Telephone Association Small Company Committee and a manager of a small rural telephone company. I want to point out today that I am here to represent only the Washington Independent Telephone Small Company Committee. I am not representing the association as such.

My testimony does not reflect the opinions of the 4 larger companies but I think it is the consensus viewpoint of the 20 small company members. I will briefly respond to the four questions that the committee asked in its letter of invitation, the first being how have the changes in the telephone communications industry affected the small companies. I would add to that question—and their customers.

Generally speaking, I think it is much too soon to demonstrate the full impact of the changes. The access charge plan at the interstate level only began on May 25 but there are two things I would like to point out where impacts have been obvious to small companies and their customers. Our cost of business has gone up dramatically because of the changes.

We have been deluged with mountains of paperwork. We have had data requests ad nauseum from every agency you can imagine. We have had to respond to this pollution of information requests with limited or no staff support. Consequently, many of us being small companies have had to rely on consulting firms to complete those necessary data requests at an extremely high cost.

Mr. Sandner estimated $150,000 in cost. I know our company has probably spent more than that in responding to this type of information. The other thing that has happened is it has increased our complexity of doing business. One of the things that we fear is that this complexity may force more centralization in the telecommunications industry, and you will see many of the small telephone companies forced out of business.

Our customers have been held hostage during the FCC access charge proceeding and the implementation. Many of them are confused and many of them are angry. They are confused because they expect rates to go down because of competition, yet rates are going up. They tend to be angry becaue they have had little opportunity to influence an FCC access charge plan that is designed to require him to subsidize inner-city competition to benefit the large inner-city companies and their Fortune 500 customers.

I am concerned because my small business customers are being forced to pay at the end of the transition period the full cost of the local loop while the inter-city carriers receive a free ride.

The second question is, will rates rise? And the answer is yes. How much is still in doubt. The State of Washington, through the good offices of the Washington Utilities and Transportation Commission, completed a study. A task force was convened including the larger and small companies. That study showed that the range of rates under the FCC access charge plan to be a high of $47.76 per month for Asotin Telephone Co. and a low of $18.92 cents for Ellensburg Telephone Co.

I would like to point out an order just issued by the Washington Commission within the last couple of weeks because it demonstrates what the impact could be on the rural telephone user. I refer to the WUTC Consolidated Cause 8360-8361 and 8401, three companies competing to serve an area 50 miles west of Seattle. The commission issued its order on who would serve that area 2 weeks ago. Those companies estimated under the access charge environment that a line for a residential customer in that area would be $15 per month.

The Commission order—I read from their findings of fact; they indicate that Inland must further agree to a toll settlement process, including all nontraffic-sensitive costs, as local exchange costs. In other words, this company cannot benefit from the pooling process. Under that finding of fact and conclusion of law, those customers will pay a $60 per month rate. I bring that up to show you the impact.

The committee also asked what special problems we might have as small companies. We foresee that long-distance rate deaveraging is going to cause us and our customers problems, not only will their local rates go up, the long-distance rates are going to go up.

We are concerned about lifeline service. Most of us agree with the concept of lifeline service but we are very concerned that a knee-jerk reaction may occur among regulators or legislators to implement a system which would be too costly for us to administer.

We are concerned about measured service. As small companies, we believe that measured service is a pricing option that may or may not be appropriate for our customers, and we do not want to be swept in. We are concerned that Congress is going to cease the REA funding program, very important to many companies, and we are also concerned about equal access, what are the costs going to be to us and our customers.

In conclusion, I would say we have two concerns; one, we are concerned about the financial health of our companies, and whether or not we can continue to meet our public service obligation. Second, we are concerned about the burden that this places on our customers. We don't agree with the FCC access charge plan which ignores joint sharing of joint costs. Thank you.

[Mr. Ericson's prepared statement with attachments follows:]

PREPARED STATEMENT OF JON C. ERICKSON, MEMBER, WASHINGTON INDEPENDENT TELEPHONE ASSOCIATION

MY NAME IS JON ERICKSON. I AM A MEMBER OF THE WASHINGTON INDEPENDENT TELEPHONE ASSOCIATION SMALL COMPANY COMMITTEE AND VICE PRESIDENT AND GENERAL MANAGER OF PENINSULA TELECOMMUNICATIONS, INC. OF FORKS, WASHINGTON.

I AM HERE TODAY TO REPRESENT THE SMALL TELEPHONE COMPANY COMMITTEE OF THE WASHINGTON INDEPENDENT TELEPHONE ASSOCIATION. MY TESTIMONY SHOULD NOT BE CONSIDERED REPRESENTATIVE OF OPINIONS HELD BY THE LARGER COMPANIES OF WITA. MY TESTIMONY DOES REFLECT THE CONCENSUS VIEWPOINT OF THE SMALL TELEPHONE COMPANIES.

WITA CONSISTS OF 24 INDEPENDENT TELEPHONE COMPANIES. THE MEMBER COMPANIES SERVE 52% OF THE STATE'S LAND AREA BUT ONLY 25% OF ALL ACCESS LINES IN WASHINGTON STATE. 20 MEMBERS OF WITA ARE SMALL TELEPHONE COMPANIES WHO SERVE THE GEOGRAPHICALLY DIVERSE AND RURAL AREAS. OUR CUSTOMERS ARE PRIMARILY RESIDENTIAL AND SMALL BUSINESS.

MY PURPOSE TODAY WILL BE TO ADDRESS THE QUESTIONS RAISED IN YOUR LETTER TO MR. JACK DOYLE, EXECUTIVE VICE PRESIDENT OF WITA.

IMPACT OF CHANGES IN THE TELECOMMUNICATIONS INDUSTRY ON SMALL TELEPHONE COMPANIES. GENERALLY SPEAKING, IT IS TOO SOON TO KNOW THE FULL IMPACT OF THE CHANGES OCCURRING IN THE INDUSTRY. FCC MANDATED ACCESS CHARGES ONLY BEGAN ON MAY 25, 1984. MOST COMPANIES WILL NOT KNOW UNTIL TRUE-UP STUDIES ARE COMPLETED EXACTLY WHAT THE FINANCIAL IMPACT OF ACCESS CHARGES WILL BE.

REGARDLESS OF THE UNCERTAINTY, CERTAIN IMPACTS APPEAR OBVIOUS. SOME OF THEM ARE:

COST OF DOING BUSINESS. SMALL TELCOS' COST OF DOING BUSINESS HAS GONE UP DUE TO THE CHANGES OCCURRING. THE SMALL TELEPHONE COMPANY HAS BEEN DELUGED WITH LITERALLY MOUNTAINS OF PAPERWORK FROM NECA, WECA, FCC, STATE REGULATORS, BOC'S, AT&T, NATIONAL ASSOCIATIONS, STATE ASSOCIATIONS, AND THE STATE LEGISLATURE.

THERE HAVE BEEN NUMEROUS NEW CONTRACTS TO ANALYZE AND NEGOTIATE, DATA REQUESTS AD NAUSEUM, TARIFFS TO FILE, ANALYZE AND IMPLEMENT. RESPONSE TO THIS POLLUTION OF INFORMATION REQUESTS MUST BE DONE WITH LIMITED OR NO STAFF SUPPORT. SMALL TELEPHONE COMPANIES DO NOT HAVE THE LUXURY OF LARGE STAFFS OF LAWYERS, ACCOUNTANTS, AND VARIOUS EXPERTS. MANY HAVE HAD TO RELY ON CONSULTING FIRMS TO COMPLETE THE NECESSARY STUDIES AT AN EXTREMELY HIGH COST PER CUSTOMER.

THE INCREASED COMPLEXITY OF DOING BUSINESS MAY WELL FORCE MORE CENTRALIZATION IN THE TELECOMMUNICATIONS INDUSTRY. MANY SMALL TELCOS MAY BE FORCED TO SELL OUT RATHER THAN CONTEND WITH THE EXTREME FRUSTRATIONS AND HIGH COSTS CAUSED BY THE CHANGES.

OTHERS IN THE STATE OF WASHINGTON HAVE BEEN STUDYING THE IMPACT OF CHANGES ON THE TELECOMMUNICATIONS INDUSTRY AND TELEPHONE CONSUMERS. THE WASHINGTON STATE LEGISLATURE, JOINT

SELECT COMMITTEE ON TELECOMMUNICATIONS, SPONSORED A TELECOMMUNICATIONS SYMPOSIUM AT THE UNIVERSITY OF WASHINGTON ON JULY 2, 1984. ONE OF THE PRESENTATIONS AT THE SYMPOSIUM WAS PARTICULARLY APPLICABLE TO THE QUESTION ASKED BY THIS COMMITTEE ON THE IMPACT OF CHANGES ON SMALL COMPANIES. IT WAS A PRESENTATION BY MR. GENE F. MICHAELSON, MANAGER, ERNST & WHINNEY, TELECOMMUNICATIONS GROUP. HIS PRESENTATION WAS TITLED, "THE IMPACT OF RECENT REGULATORY CHANGES ON SMALL INDEPENDENT TELEPHONE COMPANIES". MICHAELSON'S PRESENTATION IS ATTACHED AS EXHIBIT A. WE WOULD ENCOURAGE REVIEW OF HIS PRESENTATION SINCE IT ADDRESSES THE IMPACT ON SMALL TELEPHONE COMPANIES IN A VERY THOROUGH MANNER.

EFFECT ON THE CUSTOMER. UNFORTUNATELY, THE CUSTOMERS OF SMALL TELEPHONE COMPANIES HAVE BEEN HELD HOSTAGE DUE TO THE POORLY ORCHESTRATED TRANSITION TO A COMPETITIVE TELECOMMUNICATIONS MARKET. CUSTOMERS CONTINUE TO BE CONFUSED AND MANY OF THEM ARE ANGRY. IN THEIR STATE OF BONDAGE THE CUSTOMER SEES HIS EXCHANGE RATES GOING UP WHILE RECEIVING VIRTUALLY NO RELIEF FROM DECREASES IN LONG DISTANCE RATES, PRIMARILY BECAUSE THE AVERAGE CONSUMER DOESN'T MAKE ENOUGH LONG DISTANCE CALLS TO BENEFIT FROM LONG DISTANCE RATE DECREASES.

THE CUSTOMER IS CONFUSED BECAUSE HE EXPECTS COMPETITION TO BRING PRICES DOWN, NOT UP, YET THAT BASIC ECONOMIC PREMISE IS NOT OCCURRING. THE CUSTOMER IS ANGRY BECAUSE HE HAS

HAD SCARCE OPPORTUNITY TO INFLUENCE THE FCC ACCESS CHARGE PLAN THAT IS DESIGNED TO REQUIRE HIM TO SUBSIDIZE INTERCITY COMPETITION TO THE BENEFIT OF THE LARGE INTERCITY CARRIERS AND THEIR FORTUNE 500 CUSTOMERS.

MOST SMALL TELEPHONE COMPANY MANAGERS ARE CONCERNED WITH THE IMPACT OF THE FCC ACCESS CHARGE PLAN ON THEIR CUSTOMERS. THEY RECOGNIZE RESIDENTIAL AND SMALL BUSINESS CUSTOMERS WILL BEAR A DISPROPORTIONATE SHARE OF THE COSTS OF RECENT REGULATORY CHANGES. UNDER THE CURRENT FCC PLAN, THE RESIDENTIAL AND SMALL BUSINESS CUSTOMER IS BEING FORCED TO PAY VIRTUALLY THE FULL COST OF THE LOCAL LOOP WHILE THE INTERCITY CARRIER RECEIVES A FREE RIDE ON THAT SAME LOCAL LOOP.

WILL RATES RISE? IT REMAINS UNCLEAR HOW MUCH LOCAL EXCHANGE RATES WILL RISE AS A RESULT OF THE CHANGES OCCURRING. REGARDLESS OF THIS UNCERTAINTY, IT APPEARS OBVIOUS THAT LOCAL EXCHANGE RATES WILL GO UP AND, IN SOME CASES, DRASTICALLY. A NUMBER OF STUDIES HAVE BEEN MADE THAT HAVE ESTIMATED THE RATE IMPACT OF THE FCC ACCESS CHARGE PLAN.

ONE SUCH STUDY WAS COMPLETED IN WASHINGTON STATE IN EARLY 1983. THIS STUDY WAS MADE WITH THE ASSISTANCE OF THE GOOD OFFICES OF THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION. A TASK FORCE WAS CONVENED CONSISTING OF WITA MEMBERS AND PACIFIC NORTHWEST BELL TELEPHONE COMPANY TO DETERMINE THE NON-TRAFFIC SENSITIVE (NTS) PLANT REVENUE REQUIREMENTS FOR EACH

TELEPHONE COMPANY PROVIDING SERVICE IN WASHINGTON STATE. BASED ON 1981 DATA FROM THIS INDUSTRY STUDY, IF THE NTS REVENUE REQUIREMENTS FOR EACH ACCESS LINE WERE BORNE BY THE CUSTOMER, THEN THE CUSTOMERS OF THE ASOTIN TELEPHONE COMPANY IN EASTERN WASHINGTON WOULD HAVE TO PAY EACH MONTH CHARGES OF $47.76 (THE HIGHEST NTS REVENUE REQUIREMENT IN THE STATE), AND THE CUSTOMERS OF THE ELLENSBURG TELEPHONE COMPANY WOULD HAVE TO PAY EACH MONTH CHARGES OF $18.92 (THE LOWEST NTS REVENUE REQUIREMENT IN THE STATE). THE FULL RESULTS OF THIS STUDY WERE PRESENTED AS TESTIMONY TO THE U. S. HOUSE OF REPRESENTATIVES SUBCOMMITTEE ON TELECOMMUNICATIONS, CONSUMER PROTECTION & FINANCE, ON MARCH 22, 1983. ATTACHED AS EXHIBIT B IS A COPY OF THAT TESTIMONY. FURTHER REFINEMENTS HAVE BEEN MADE IN THAT STUDY BUT THE GENERAL RANGE OF EXPECTED LOCAL RATE INCREASES DOES NOT CHANGE SIGNIFICANTLY. SOME IN THE INDUSTRY CLAIM LOCAL RATES WILL BE HIGHER THAN THOSE ESTIMATED IN THE MARCH 22, 1983 STUDY, AND SOME SAY THEY WILL BE LOWER. ONLY TIME WILL TELL WHO IS CLOSEST TO BEING CORRECT.

OTHER TESTIMONY AND STUDIES HAVE BEEN OFFERED IN VARIOUS HEARINGS AND SYMPOSIUMS REGARDING THE ESTIMATED IMPACT OF THE FCC ACCESS CHARGE PLAN. FOLLOWING IS A REPRESENTATIVE LIST OF SOME TESTIMONY OFFERED BY WASHINGTON STATE SMALL TELCO REPRESENTATIVES:

1. HEARING BEFORE THE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION - UNITED STATES SENATE - FIRST

SESSION ON LOCAL TELEPHONE RATES - AUGUST 29, 1983 - TESTIMONY OF (SEE EXHIBIT C):

A. CARLTON APPELO, MANAGER, WESTERN WAHKIAKUM TELEPHONE COMPANY.

B. JON C. ERICKSON, VICE PRESIDENT, PENINSULA TELECOMMUNICATIONS, INC.

2. HEARING BEFORE THE SUB COMMITTEE ON HOUSING AND CONSUMER INTERESTS OF THE SELECT COMMITTEE ON AGING - HOUSE OF REPRESENTATIVES - FIRST SESSION - AUGUST 11, 1983 - TESTIMONY OF (SEE EXHIBIT D):

A. EWART PETERSON, PRESIDENT, TENINO TELEPHONE COMPANY.

3. NINTH ANNUAL RATE SYMPOSIUM, PRESENT & FUTURE PRICING ISSUES IN ELECTRIC, GAS AND TELECOMMUNICATIONS INDUSTRIES - FEBRUARY 6-9, 1983 - KANSAS CITY, MISSOURI - PRESENTATION BY (SEE EXHIBIT E):

A. JON C. ERICKSON, VICE PRESIDENT, PENINSULA TELECOMMUNICATIONS, INC., ACCESS CHARGES & THE RURAL DILEMMA.

SPECIAL PROBLEMS. IN ADDITION TO THE ISSUES ALREADY ADDRESSED IN THIS TESTIMONY, THERE ARE OTHER POTENTIAL PROBLEMS FACING SMALL TELCOS AND THE RESIDENTIAL AND SMALL BUSINESS CUSTOMERS THEY SERVE. SOME OF THESE PROBLEMS ARE:

LONG DISTANCE RATE DEAVERAGING. MANY IN THE INDUSTRY BELIEVE THAT EVEN THOUGH WE MAY SEE SOME LONG DISTANCE RATE DECREASES, THE PROBABILITY IS COMPETITION WILL CAUSE DEAVERAGING OF LONG DISTANCE RATES. IF THIS DOES HAPPEN, CUSTOMERS IN RURAL AREAS CAN EXPECT LONG DISTANCE RATE INCREASES, NOT DECREASES. THE REASON LONG DISTANCE RATE DEAVERAGING MAY OCCUR IS DUE TO THE RELATIVE ISOLATION OF MOST RURAL AREAS AND THE FACT TOLL ROUTES SERVING THEM ARE LOW DENSITY/HIGH COST ROUTES.

IN THE DEBATE ON UNIVERSAL SERVICE, LITTLE MENTION IS MADE OF THE FACT THAT AFFORDABLE LONG DISTANCE SERVICE IS AS IMPORTANT TO MANY ISOLATED AREAS AS AFFORDABLE LOCAL EXCHANGE SERVICE. THE SMALL COMPANIES OF WASHINGTON STATE BELIEVE IT IS IMPERATIVE DEAVERAGING OF RURAL LONG DISTANCE RATES DOES NOT OCCUR.

LIFELINE SERVICE. BECAUSE OF THE ANTICIPATED SIGNIFICANT INCREASES IN LOCAL EXCHANGE RATES, THERE COULD BE PRESSURE FROM BOTH THE REGULATORY AND LEGISLATIVE ARENA FOR MANDATORY LIFELINE RATES. MANY SMALL TELCOS SUPPORT THE LIFELINE SERVICE CONCEPT; HOWEVER, THEY ARE CONCERNED THAT IMPLEMENTATION AND ADMINISTRATION OF LIFELINE SERVICE COULD BURDEN THEM WITH COSTLY ADMINISTRATIVE EXPENSES. LIFELINE SERVICE, IF IMPLEMENTED, SHOULD BE ADMINISTERED BY THOSE GOVERNMENTAL AGENCIES STAFFED TO COPE WITH THIS TYPE OF PROGRAM.

MEASURED SERVICE. SMALL TELCOS ARE CONCERNED THE MOVEMENT TO IMPLEMENT MEASURED SERVICE BY LARGER COMPANIES WILL FORCE THEM INTO OFFERING MEASURED SERVICE. SOME IN THE INDUSTRY ARGUE MEASURED SERVICE IS THE ANSWER TO THE LIFELINE SERVICE REQUIREMENT. HOWEVER, WASHINGTON STATE SMALL TELEPHONE COMPANIES GENERALLY BELIEVE MEASURED SERVICE IS A PRICING OPTION WHICH MAY OR MAY NOT BE APPROPRIATE FOR SMALL TELCOS TO IMPLEMENT. SMALL TELCOS SHOULD NOT BE FORCED TO IMPLEMENT MEASURED SERVICE UNLESS IT CAN BE CLEARLY DEMONSTRATED IT WILL BE COST EFFECTIVE AND OF BENEFIT TO THEIR CUSTOMERS.

REA FUNDING. MANY SMALL TELEPHONE COMPANIES IN WASHINGTON STATE ARE FINANCED BY THE REA. SURVIVAL OF THE REA PROGRAM MAY WELL BE MORE IMPORTANT IN THE 80'S AND 90'S THAN IN PAST YEARS. WE ARE HOPEFUL CONGRESS RECOGNIZES THE IMPORTANCE OF THE REA PROGRAM.

EQUAL ACCESS. SMALL TELEPHONE COMPANIES DO NOT KNOW AT THIS TIME WHAT EQUAL ACCESS REQUIREMENTS WILL BE IMPOSED UPON THEM. FOR COMPANIES WITH DIGITAL SWITCHES ALREADY INSTALLED, EQUAL ACCESS MAY NOT BE A PROBLEM; BUT, FOR THOSE COMPANIES UTILIZING ELECTROMECHANICAL SWITCHES, EQUAL ACCESS COULD REQUIRE LARGE CAPITAL EXPENDITURES WHICH THEIR CUSTOMERS CANNOT AFFORD THROUGH INCREASED RATES.

CONCLUSION. THE SMALL COMPANY COMMITTEE OF WITA IS EXTREMELY CONCERNED ABOUT THE KNOWN AND POTENTIAL IMPACTS OF

CHANGES WHICH HAVE OCCURRED AND WILL BE OCCURRING IN THE TELECOMMUNICATIONS INDUSTRY AS BROUGHT ABOUT BY FCC DECISIONS AND DIVESTITURE OF THE BELL SYSTEM. OUR CONCERN IS TWOFOLD: WE FEAR FOR THE FINANCIAL HEALTH OF OUR COMPANIES AND OUR ABILITY TO MEET OUR PUBLIC SERVICE RESPONSIBILITIES GIVEN THE UNCERTAINTY OF THE CURRENT ACCESS CHARGE ENVIRONMENT; AND, OF EQUAL PRIORITY AND CONCERN IS THE IMPACT OF THE CHANGES ON OUR CUSTOMERS AND THEIR ABILITY TO SHOULDER THE BURDEN OF THE FULL COST OF THE LOCAL EXCHANGE PLANT.

WE DO NOT SUPPORT THE CURRENT FCC ACCESS CHARGE PLAN WHICH IGNORES THE JOINT SHARING OF JOINT COSTS OF THE LOCAL EXCHANGE PLANT. WE SINCERELY HOPE THAT CONGRESS WILL AGGRESSIVELY AND VIGILANTLY MONITOR THE FCC AND ENCOURAGE, IF NOT REQUIRE, THE FCC TO REVISE ITS ACCESS CHARGE PLAN SO RESIDENTIAL AND SMALL BUSINESS TELEPHONE CONSUMERS WILL BE TREATED EQUITABLY.

IF THE FCC ACCESS CHARGE PLAN IS ALLOWED TO BE FULLY IMPLEMENTED IN ITS PRESENT FORM, WE MAY WELL BE WITNESSING THE BEGINNING OF THE SILENCING OF RURAL AMERICA.

SMALL COMPANY COMMITTEE OF WASHINGTON INDEPENDENT TELEPHONE ASSOCIATION:

RICHARD J. BUECHEL, CHAIRMAN, HOOD CANAL TELEPHONE COMPANY

TONY POTTRATZ, COWICHE TELEPHONE COMPANY

RONALD M. COFFEY, KALAMA TELEPHONE COMPANY

JAMES P. CERVENY, JR., LEWIS RIVER TELEPHONE COMPANY

JON C. ERICKSON, PENINSULA TELECOMMUNICATIONS, INC.

LARRY DICKERSON, ST. JOHN TELEPHONE COMPANY

THE IMPACT OF RECENT REGULATORY CHANGES ON SMALL, INDEPENDENT TELEPHONE COMPANIES

by Gene E. Michaelson, Manager
Ernst & Whinney
Telecommunications Group

Presented at the Joint Select Committee on
Telecommunications Symposium

Introduction

During the past few months, the telecommunications industry has received an uncharacteristic amount of exposure in the popular press. Who would have thought a few years ago that an issue as technical and as arcane as access charges would be hotly debated in Congress (in an election year, no less) and that Commissioner Fowler would be quoted regularly in *Time* magazine? Surely public awareness of telephony is at an all-time high.

But certain players in the telecommunications industry have been stealing the spotlight. AT&T has been the subject of innumerable articles in the wake of the January 1, 1984, divestiture. The divested Bell Operating Companies (BOCs) have received equal time as investment bankers have speculated endlessly on the financial viability of AT&T

and the Regional BOCs (RBOCs)--the "Pieces of Eight"--in a post-divestiture world. And the Other Common Carriers (OCCs), flamboyant as ever, are wallowing in publicity as subscribers in Charleston, West Virginia, decide which long-distance carrier to subscribe to and as the proverbial little old lady in tennis shoes at last begins to realize that Ma Bell is dead and that AT&T is not the only way to reach Pocatello, Idaho.

I would like to take a few minutes to address the concerns of another group of key players in the telecommunications industry, one that has received relatively little publicity: the Independent telephone companies. These companies, some 1,400 strong, are the mainstay of telephony in rural America. They too have been profoundly affected by the recent tumultuous changes in the industry. And in some ways, I would argue, these regulatory changes are affecting the day-to-day operations of these small telephone companies more than they are impacting the mighty RBOCs.

Conventional wisdom is that the Modification of Final Judgment (MFJ) and the Plan of Reorganization to which it gave birth affect only AT&T and the BOCs. Anyone who works in a small, Independent telephone company would be quick to assert that this is certainly not the case. To pick just one example, the creation of LATAs, which was not mandated by the MFJ but developed in response to its requirements, has profoundly affected the operations of certain Independents even though LATA configurations were meant to provide a means of separating AT&T

and BOC facilities. In states where local exchange carriers are billing and keeping access charges for intrastate interLATA toll, certain Independents are experiencing substantial revenue shortfalls.

The advent of access charges, spurred by both the MFJ's requirement of unbundled, nondiscriminatory access tariffs and the decision in CC Docket No. 78-72 that competition in the MTS/WATS market was indeed in the public interest, has also had a profound effect on the Independents. The nightmare of interim interstate settlements, the demise of the settlements procedures, the intricacies of Carrier Access Billing, the implementation of intrastate access charges mirroring interstate tariffs that bear little resemblance to those that became effective on May 25--all of these events have affected the Independent industry. And, without a doubt, greater changes lie ahead. What equal access requirements will be imposed upon Independents? Will subscribers of small, rural telephone companies be assessed end user charges? Will the shift of costs to the intrastate jurisdiction (in the case of companies with high Subscriber Plant Factors (SPFs)) cause local rates to skyrocket? Will high-cost Independents truly recover all of their costs in a manner that will not jeopardize universal service? These are the questions on the minds of owners of the Independent telephone companies.

Ironically, many of the companies facing these grave problems are those that are the least able to bear additional administrative and operational burdens. The Independent clients whom Ernst & Whinney typically serves do not have staffs of attorneys to puzzle through the darker passages of the Orders released by the FCC. Nor do they wield the political power or have the financial wherewithal of the BOCs.

Let us take a closer look at these Independent companies, looking first at general characteristics and then focusing on the Independents of Washington State and their subscribers. Who are these companies and how do the regulatory changes of the past few months affect them?

The Independent Industry

A few statistics drawn from USITA's (now USTA) Independent Telephone Statistics (published July 1983) will serve as a good introduction to these companies and will illustrate how they compare with the BOCs.

	Independents	Bell	Total
Access Lines	21,672,000 (20%)	86,921,000	108,593,000
Operating Companies	1,432	25	1,457
Exchanges	11,074 (62%)	6,874	17,948
Plant Investment	$41,500,000	$160,198,838	$201,698,838
Total Operating Revenues	$13,880,000	$65,698,000	$79,578,000
Employees	192,100	840,675	1,032,775

As you can see, the Independent industry is highly fragmented. There are over 1,400 Independent telephone companies in the United States, some of them serving only a few hundred subscribers. The Independents' revenues and investments in plant and personnel are dwarfed by those of the seven RBOCs, but the small Independents are nevertheless a major force in American telephony. Sixty-two percent of telephone exchanges nationwide belong to Independents. Even more telling is the land mass served by these companies. According to a report issued by the National Telecommunications and Information Administration in 1981 (NTIA Report 82-97), the BOCs serve 31.36 percent of the country's land mass, whereas the Independents collectively serve 44.27 percent (24.37 percent of the land mass is water and otherwise "undesignated"). These statistics illustrate that it is, to a large extent, the Independents that have borne the banner of "Universal Service" into the more sparsely populated and remote areas of this country.

What are some of the characteristics of these companies? Without a doubt, the vast majority are small, in terms of both revenues and access lines. In 1982 only four Independents--the four largest holding companies--had more than a million access lines. Only thirteen companies had more than 100,000 lines. Even more significantly, a scant 32 companies had more than 25,000 access lines to their name. In many cases, these companies have high operating costs and are financially vulnerable. Many are very highly leveraged. For example, in 1982 the average ratio of net worth to total assets for REA borrowers was only 26.3 percent. These are high risk companies.

One reason for the high risk is that the sparsely populated, remote areas that some of these companies serve necessitate unusually high plant investments, the costs of which are spread over an unusually small number of subscribers. For example, one of our clients in the Southwest, Arizona Telephone Company, serves an Indian reservation that can be reached only by mule or helicopter. Another client, Western New Mexico Telephone Company, faces similarly hostile terrain. As a result, Western New Mexico's average unseparated cost per subscriber loop is nearly $60 per month as compared to a national average cost per loop of $19.

The high cost per loop of small, rural Independents is predictable given these companies' very low number of telephones served per square mile. The smaller Independents (i.e., other than the handful of large holding companies like GTE, United, Continental, Centel, and ALLTEL) serve on the average only 8.58 phones per square mile. In contrast, the BOCs serve an average of 128.57 phones per square mile. It is little wonder that these Independents are worried about whether the FCC proposed Universal Service Fund will adequately assist them in covering their high costs. Nor is it surprising that they are concerned about the percentage of their costs that will have to be recovered from their small and often impoverished subscriber base.

Washington State Independents

Most of the Independents of Washington State exhibit the characteristics of the Independent companies described above. Of the 24 Independents operating in the State in 1982, three served fewer than 1,000 telephones and Hat Island Telephone Company served only 38. Some are very highly leveraged: the highest ratio of net long-term debt to total capitalization being Hood Canal Telephone Company's 77.14 percent. The areas served by these companies are often sparsely populated: Pioneer Telephone Company, to pick an extreme example, serves only 1.95 subscribers per route mile. And, as could be expected, these companies have higher than average costs per subscriber loop. Western Wahkiakum County Telephone Company, which operates 670 access lines at the southwestern tip of the Olympic Peninsula, has unseparated costs per loop per month of approximately $50, compared with the national average of $19.

But, as is the case for the Independent industry as a whole, the Independent telephone companies of this state play a vital role in bringing telephone service to the people. In 1982 the Independents had a total of 565,256 access lines. Moreover, according to the NTIA report referenced earlier, Bell served 30 percent of the state's land mass, the three largest Independents (GTE, United, and Continental) served 25.9 percent, and the smaller Independents covered an additional 15.4 percent of the land area. Obviously, these small Independents cannot be ignored. AT&T, the BOCs, and the OCCs may monopolize the limelight, but the particular concerns of Independents must also be addressed.

Many owners of Independent telephone companies are concerned, first and foremost, with the subscribers they serve. The feeling, not only among Washington State Independents but also among small telephone company operators across the nation, is that their subscribers may be forced to bear a disproportionate share of the costs of recent regulatory changes, but that these people will be the last to benefit from the new era of competition these changes are intended to usher in. Equal access will certainly come to Seattle and Spokane before it comes to the wilds of La Center. Moreover, many subscribers of these small, rural telephone companies are the least able to bear the burden of higher local rates. According to the 1980 Census of Population, the average annual per capita income of people living in places with between 2,500 and 10,000 in population is 15 percent lower than the average annual per capita income of the nation as a whole.

The chart below presents a few select statistics for counties in which Independents have a predominant presence. These counties are compared with King County, where Pacific Northwest Bell holds sway.

County	1981 Personal Income Per Capita [1]	Rank (39 Total)	Pop. Density[1]	Rank (39 Total)	Pop. (1983)[1]	Rank (39 Total)	Annual Payroll in '000 (1982)
Asotin	$ 9,527	(27)	26.5	(20)	16,800	(28)	$ 20,906
Whitman	9,162	(33)	18.5	(23)	39,900	(20)	48,829
Wahkiakum	9,495	(29)	14.2	(26)	3,700	(38)	8,294
Clallam	10,376	(18)	29.8	(18)	52,200	(15)	139,627
Lewis	10,599	(14)	23.2	(22)	56,000	(14)	202,621
San Juan	11,294	(9)	48.6	(12)	8,700		17,504
King	13,675	(4)	618.3	(1)	1,315,800		10,991,306

[1] Source: Washington State Data Book, 1983
[2] Source: County Business Patterns, 1981, p. 21

As you can see, these counties are relatively sparsely populated and exhibit both smaller economic bases and lower per capital income. If there is a threat to Universal Service, these subscribers will be the first to disconnect.

Traditonal Revenue Sources/Separations

The recent changes in regulatory policy may be formulated by economists and lawyers in Washington, D.C., but they affect the bottom lines of these small companies by radically altering their revenue sources. Traditionally, these companies obtain a small percentage of their operating revenues from local service. In 1982, the average Independent obtained only 38.7 percent of its revenue from local service with 58.6 percent coming from toll and miscellaneous services. Some Independents have not sought rate relief in years, depending instead on toll revenues. In 1982, toll revenues as a percentage of operating revenues (after uncollectibles) for all Washington State companies (Independents plus Bell) was 52 percent. For the Independents, however, toll revenues as a percentage of total operating revenues ranged from a low of 55.35 percent for GTE to a high of 84.46 percent for Inland Telephone Company. (Cascade Autovon Company, which provides service only to the Federal government, received 100 percent of its revenues from toll.)

Back in the days of separations and settlements, this toll revenue was relatively certain and predictable. Now, however, the separations procedures are undergoing radical changes and the settlements and division of revenues process has already faded into history with the advent of divestiture and access charges. Toll revenue is of such importance to Independents that a closer look at both separations and access charges is in order.

Broadly speaking, the term "separations" refers to the assigning of telephone company costs to the interstate toll, state toll, and local jurisdictions. In the past, Bell and Independent companies prepared separations studies to apportion their total costs among these jurisdictions. The toll costs of these individual companies were aggregated to determine the total toll cost or revenue requirement. A toll rate schedule was then designed which, when applied against expected toll usage, would produce revenues to cover total toll cost. Upon approval by the appropriate regulatory body (FCC or state commission), a uniform (i.e., the same rate per minute for a call of equal distance between any two points) toll rate schedule would go into effect. Customer usage would then generate a "pool" of total toll revenues. The same procedure used to determine the total toll cost in the ratemaking process was then used to divide the toll revenue pool.

The costs assigned to "local" were recovered by each company independently through individual basic exchange rates.

The basic principles which underlie the separations process and which are incorporated into the FCC's Separations Manual were, in general, established in two landmark cases. In 1913, the Supreme Court decided, in what is commonly referred to as the "Minnesota Rate Case," that "use units" must be factors for allocating jointly used property (most telephone company costs are joint costs). Then, in 1930, Smith vs. Illinois Bell Telephone Company established the premise on which the "station-to-station" theory of separations is based. Prior to this time, it was commonplace for the Bell companies to utilize the "board-to-board" theory for setting toll rates. This theory said that the only costs that would be considered for toll ratemaking would be the costs from the originating toll board to the terminating toll board. Exchange plant costs (stations, local distribution facilities, local dial equipment, etc.) were excluded from toll rate considerations.

A set of uniform separations procedures was incorporated in the first Separations Manual, which was released by the FCC and NARUC in 1947

The evolution of separations procedures from 1947 to the present illustrates the industry dictum "Costs are as costs are defined." During the post-war years, the introduction of microwave technology led to a dramatic decrease in the cost of interstate toll service. Local service, on the other hand, remained as costly or even increased in cost. The upshot of this technology-driven change was upward pressure on local rates and downward pressure of long-distance rates. Indeed, if AT&T's rates were not adjusted in some manner, the company would have greatly exceed its authorized rate of return.

Rather than decrease AT&T's long-distance rates, it was decided instead to shift costs from the intrastate/local jurisdiction to the interstate jurisdiction. This shift was accomplished by a new separations allocator, the Subscriber Plant Factor (SPF), which was the heart of the Ozark Plan incorporated in the revised Separations Manual of 1971. The SPF is a very important factor since it is used to allocate a telephone company's jointly used or non-traffic sensitive costs. These costs may constitute over 60 percent of a small telephone company's costs. The use of SPF results in the assignment of more non-traffic sensitive costs to interstate than did the use of the various raw or unweighted minutes-of-use factors which had been used since 1947.

While the national average for interstate SPF is roughly 25 percent, i.e., 25 percent of non-traffic sensitive or subscriber loop costs are assigned to the interstate jurisdiction, some Independent companies have extremely high SPFs. For example, two of the companies in

Washington State for which Ernst & Whinney performs separation studies, Lewis River and Mashell, have interstate SPFs of 44.0 percent and 35.4 percent.

In CC Docket No. 80-286, the FCC ordered that all companies would freeze their interstate SPFs at 1981 levels and then begin a gradual "phase-down" to a 25 percent level. The phasing down to a 25 percent interstate SPF will, of course, result in a drastic change in the source (and certainty) of an Independent's recovery of the costs of the local loop. A company with a total SPF (interstate plus intrastate) of 80 percent, for example, previously recovered this amount from the Bell system in the settlements process. This cost recovery was relatively assured and did not impact directly on the Independent's subscribers. If and when transition to a 25 percent allocation factor is complete, these companies will assign only 25 percent to the interstate jurisdiction, with most of these costs eventually being recovered from the local subscriber (called interstate end user common line or access charges) under the FCC's plan. The rest is to come from intrastate and local. Granted, high-cost companies will receive some relief from the Universal Service Fund or a comparable form of assistance, but the manner in which these costs will be recovered is anything but certain at this date. Independent telephone companies are quite understandably concerned about the potential shifting of costs to the intrastate/local jurisdiction. It remains unclear in Washington State and in most other states what percentage of these costs will be borne directly by subscribers. But it is clear that the flat rate monthly charges paid by subscribers will increase and that rural customers will probably experience larger increases when compared to their urban counterparts. In addition, the rural customers will probably not experience, at least in the near term, the much talked about decreases in long-distance rates which city dwellers will receive.

Most of a telephone company's interstate access costs were recovered through the separations and settlements/division of revenue procedures I have briefly described. The emergence of Other Common Carriers (OCCs) such as MCI, whose interstate revenue was not pooled, necessitated a second cost recovery procedure for switched access: the ENFIA tariffs. These tariffs established the rates that OCCs would pay local exchange carriers for originating and terminating Execunet and other services deemed functionally equivalent to MTS/WATS. A third cost recovery mechanism was that applied to FX and CCSA services whereby telephone companies charged interstate FX and CCSA subscribers the local business exchange rate at the open end. In addition to these three methods-- settlements/DOR, ENFIA, and FX/CCSA--a host of other arrangements governed the recovery of private line revenue requirement.

Access Charges and Other Recent Regulatory Developments

This variety of cost recovery methods is what FCC Chairman Mark Fowler has called the "crazy quilt pricing" of access. The FCC contends that the variations in the pricing of access services were not cost-based. For example, MTS/WATS-type service and the open end of FX/CCSA services use identical local exchange facilities. Nevertheless, FX/CCSA subscribers paid the local business exchange rate whereas the OCCs paid ENFIA rates.

The Commission decided in CC Docket No. 78-72 that this hodgepodge of cost recovery mechanisms should be replaced by a single, non-discriminatory system of access charges. The development of these access charges was rendered all the more urgent by the Modification of Final Judgment in the AT&T antitrust case, which required that the division of revenues procedure be abolished and replaced by unbundled, tariffed rates for access. The division of revenues/settlements "partnership" was dissolved on January 1 of this year. On May 25, the access charges for interstate switched services were implemented.

Under a system of access charges, telephone companies recover their toll costs by charging the interexchange carriers a tariffed access rate per minute of use for originating and terminating calls in their service areas. In addition, multiline business subscribers and, perhaps, residential subscribers in the future, are charged a flat-rate access charge. Companies may participate in the pooling of revenue requirements and interstate access charge revenues. Companies not participating in all of these pools will bill and keep their access revenue and hope that they fully recover their revenue requirement.

Washington State and some other states throughout the country began implementing intrastate access charges for interLATA services on

January 1, 1984. In Washington, each company was required to file or concur in an access tariff which "mirrored" their interstate tariff. The companies are required to bill and keep their intrastate interLATA access charges--there is no pool for these costs. End user charges were implemented for four months in Washington and then rescinded.

How do access charges affect Independent telephone companies? It would be easier to make a list of ways in which access charges do not impact these companies. Perhaps the effects can be classified into three broad categories: (1) impact upon subscribers, (2) impact upon daily operations and administration, and (3) impact upon revenues and financing. Time permits us to examine these three areas only briefly.

The FCC has responded to political pressure and deferred end user charges for residence and single-line businesses until June 1, 1985. This temporary reprieve was welcomed by small, Independent telephone companies, many of whose subscribers could ill afford any rise in their basic telephone bill. But the future of these end user charge is still in doubt, the subject of one of the FCC's controversial supplementary proceedings. Many small telcos are championing the argument, advanced in a letter written to FCC Chairman Mark Fowler by Kansas Senator Robert Dole, that small telcos should have the option of not assessing this charge upon their customers, even after June 1, 1985. Small telephone companies are concerned with the effect of end user charges on universal service. Larger telcos, on the other hand, are often more concerned with the bypass (by large users) that could result if costs are not shifted to end users and continue to be recovered through toll loading.

As the debate on residential and single-line business end user charges rages, the charge for multiline business users is now in effect. The charge is a maximum of $6.00 per line per month; the nationwide average is roughly $4.75. Such costs are readily absorbed by Fortune 500 corporations, but have a larger relative impact on the small multiline businesses that Independent typically serve. Congressional action to exempt all small business from this charge has thus far been to no avail.

The implementation of intrastate, and now interstate, access charges has been a monumental administrative headache for small Independents. Companies with miniscule staffs have had to cope with the intricacies of Carrier Access Billing Systems, with filing their own tariffs (or joining a pool and running the risk of not recovering costs), and with responding to innumerable data requests. In addition to dealing with the havoc this new access pricing system has wreaked on daily operations, telephone company operators have had to respond to a confused public. Small Independents simply lack the manpower and the resources to assimilate such radical changes within such a short period of time.

The confusion ultimately trickles down to be reflected in the Independent's bottom line. Perhaps the most serious problem at the moment is that numerous Independents are not recovering their costs from intrastate pools. The adequacy of recovery on the interstate side remains to be seen. In addition, some companies are experiencing cash flow problems due to the fact that their revenues are now coming from multiple sources, at different times of the month (if at all), in a manner which is confusing to most companies.

A related problem is that of obtaining the level of financing needed to continue to offer quality service. Small, high-cost telcos lack many of the revenue sources open to larger, diversified companies and often lack the resources needed to finance new ventures. Since there is no public market to speak of for their stock, the Independents have relied to a large extent on the financing offered by the Rural Electrification Administration's (REA) revolving fund and Rural Telephone Bank (RTB) programs. In 1982, there were 1,000 REA borrowers. In Washington State alone, 20 of the Independents received funds from the REA and 9 from the RTB.

Nationwide, one thousand Independent telephone companies depend on the REA's revolving fund, borrowing about $250 million a year. These loans are vital to rural telephone systems whose costs are, on average, about 40 percent higher than those of telephone companies serving predominantly urban areas. Nevertheless, this important source of low interest funds is endangered. The problem in dollars and cents is simply that the REA program pays out more than it takes in, paying as much as 15 percent to the Treasury Department on money borrowed for the loans but charging its own borrowers a maximum of 5 percent interest (RTB rates are higher). REA officials project that the revolving fund will operate at a deficit by 1987 and, perhaps, go bankrupt by the end of this century.

Another problem is that some claim the REA program has already fulfilled its universal service mission. When the program began in 1949, the penetration of telephone service in rural America was only about 30 percent. By 1980, however, the lowest rate of household penetration by state was Alaska's 83.7 percent. The penetration in Washington State was 94.4 percent, slightly above the national average of 92.9 percent. Critics of the REA program, which include the Reagan Administration, point to these figures as well as to the program's financial woes, concluding that it has outlived its usefulness.

Hope for the REA's survival now depends to a large extent on pending Congressional legislation. Earlier this year, the House passed H.R. 3050, the Rural Electrification and Telephone Revolving Fund Self-Sufficiency Act of 1983. This bill calls for a forgiveness of debt as well a a higher interest rate (up to 8.5 percent by 1990) assessed to REA borrowers on new revolving fund loans. Final action on Senate companion bill S. 1300 has not yet been taken. The Agriculture Committee has marked up the bill, but it remains unclear whether it will reach the Senate floor during this legislative session.

While awaiting further Congressional action, the REA is continuing its program. For example, on May 21 the REA approved a $7.2 million loan which will enable Dell Telephone Cooperative to construct 435 miles of telephone line to extend service to 460 potential subscribers in southeast New Mexico and southwest Texas and to upgrade existing service to one-party service. The REA is also actively investigating new technologies and strategies for reducing the cost of rural service. The REA seeks to lighten its burden by encouraging those borrowers who are pursuing new ventures to form separate subsidiaries and obtain commercial financing to fund their competitive businesses.

Conclusion

Independent telephone companies have played a leading, though often unsung, role in the building of the national network. Small, rural telephone companies in Washington State and throughout the nation have engaged in the risky, sometimes financially unrewarding task of bringing telephone service to people far beyond the service areas of the larger system companies and the BOCs. The entire network has benefited from these pioneers.

The Independent industry is committed to continuing to provide quality service to rural America; however, the recent changes in regulatory climate outlined briefly above may hamper their efforts. Changes in separations procedures, the possibility of having to adopt a new Uniform System of Accounts, inadequate cost recovery through access charges, increased difficulty in obtaining low-interest financing, the specter of deaveraged toll rates--all of these recent and prospective developments have a negative impact on Independents and their subscribers.

The BOCs and larger Independents certainly share many concerns, but the small, high-cost Independents serving rural and remote areas share a particular set of concerns that must be addressed. The FCC has recognized that all local exchange carriers are not alike. The Commission's recent request for comments in CC Dockets No. 80-286 and 78-72 demonstrate the Commission's willingness to consider the problems facing this class of telephone company.

Recognition of small Independents is also necessary at the state level. While increased flexibility and stepped-up deregulation should be accorded to all exchange carriers, it is especially important for telephone companies with fewer than 10,000 subscriber loops. These companies must focus their limited resources on providing telephone service rather than complying with counterproductive regulations. The cost of regulation is very high for these companies if figured on a per-subscriber basis. State regulatory actions that should be considered include:

- Detariffing of all competitive offerings to allow telephone companies to better respond to market conditions.

Granting more flexibility regarding recovery of intrastate access revenue requirement. For example, if the current intrastate intraLATA settlement procedures do not allow telephone companies to fully recover their revenue requirements, the state commissions should promptly consider alternative procedures which properly balance the goal of universal service with the need to prevent uneconomic bypass. In addition, if end user access charges are implemented (or reinstituted) at the state level, the commissions should follow the FCC's lead and consider whether or not the small, Independent telephone companies should have to levy these charges in full, in part, or not at all.

- Allowing rate increase that fall within an established "zone of reasonableness" to become effective without protracted hearings. The regulatory structure adopted by the Iowa State Commerce Commission deserves consideration. In Iowa, telephone companies with fewer than 15,000 loops are service regulated but not rate regulated. Service regulation encompasses, among other things:

  - The maximum allowable level of deposits
  - Credit for outages
  - Uniform applicability of charges, i.e., no discrimination among customers of the same class
  - Multi-party service requirements (only one-party through four-party service may be offered)

> Lack of rate regulation means that, while companies must inform the Commission of rate increases, these increases need not be cost justified or formally approved by the Commission. This system of regulation has apparently worked satisfactorily thus far in that it has not resulted in rates significantly higher than those of regulated companies. The true test, however, will be the magnitude of increases in local rates implemented by small telephone companies as their toll revenues begin to dwindle.

Independent telephone companies can survive and prosper in this changing environment. On balance, they have served their role well over the years. They have provided the services required in their areas by knowing and working closely with their subscribers. The lifting of some regulatory restrictions and the recognition of the unique circumstances of the Independent companies at both the state and federal level will allow these telephone companies the freedom to meet today's challenges and to continue to provide high quality service to their subscribers.

A Presentation

Of The

Washington Independent Telephone Association

To The

U.S. House of Representatives

Subcommittee On Telecommunications, Consumer Protection And Finance

March 22, 1983

Jon C. Erickson
Vice President & General Manager
Peninsula Telephone & Telegraph Company
P. O. Box 90
Forks, Washington 98331
(206) 374-6212

David D. King
President
United Telephone Company
of the Northwest
601 State Street
Hood River, Oregon 97031
(503) 386-0222

My name is David D. King, President of United Telephone Company of the Northwest. Accompanying me is Mr. Jon C. Erickson, Vice-President and General Manager of Peninsula Telephone and Telegraph Company.

Mr. Erickson and I are here today as representatives of the Washington Independent Telephone Association ("WITA"). WITA consists of 24 independent telephone companies dedicated to modern and efficient telephone service at reasonable prices (Exhibit #1). The member companies serve over half of the state's land area but only 580,091, or 27.6%, of all access lines in Washington State (Exhibit #2). These areas are geographically diverse and primarily rural.

Our purpose today is to outline the work we have been doing in Washington state and to assess the telephone rate impact of various regulatory decisions made in the last several years. We have also emphasized the recent Federal Communications Commission ("FCC") decision on access charges. We think you will find this information helpful. We also suspect that you will be surprised by the basic rate increases your constituents will experience.

Communications Act

In the early part of this century before extensive regulation, numerous telephone companies began to offer service in the same areas. Frequently, these companies did not interconnect with one another and customers desiring to call all other stations in the same town had to have two or three telephones in their businesses or residences. Congress concluded that this duplication of service facilities was an obvious waste which, among other things, threatened its desire for the widespread provision of telephone service to all members of the public. In order to resolve these problems, Congress passed the Communications Act of 1934 and specifically stated that one of the primary purposes of the Act is:

> "...to make available, so far as possible, to all of the people of the United States a rapid, efficient, nation-wide ... wire...communications service with adequate facilities at reasonable charges..."

This language embodies the concept that has become known as "universal telephone service." The specific meaning given to the concept of universal service by federal and state regulators over the past half-century involves the pricing of local service at low enough levels to presumably allow almost all households to have a telephone. Because the provision of local telephone service is both capital intensive (i.e., it requires considerable investments in switching, transmission and distribution facilities) and expensive, contributions from other services were necessary to keep monthly rates below the actual cost if universal service was to be successfully promoted.

Contributions to Local Service

Over the years, a dual system of contributions was developed by the industry and its regulators. First, the rates for telephone service provided to business customers were set at levels two or more times higher than for residence customers even though the costs to the telephone company were generally the same. The disparity was justified by the belief that the service was worth more to business (the so-called "value of service" concept), and business was better able to bear the added expense.

The second major source of contribution to local service is long distance (or toll) revenues. A part of the investment in facilities, which are jointly used to provide both local and long distance services, is allocated to and considered as a cost of long distance service, and recovered from the pool of interstate long distance revenues (known as toll settlements). These jointly used, or common, facilities have traditionally included the telephone instrument (known as Customer Premises Equipment, or CPE), the premises or inside wiring, and the outside cable pair from the customer's premises to the telephone company's serving central office (or exchange) switching facilities (commonly referred to as the "local loop") as well as part of the Central Office. (Exhibit #3)

The Separations Process, Competition and Deregulation

The allocation of these common facility costs between local and long distance services is known as the "separations process." Over the years, the industry and federal regulators have agreed to a variety of methods to allocate the costs of these common facilities between local and long distance services, the most recent being the Ozark Plan, developed in 1970. However, due to the increase in long distance usage during the 1970s and the effects of inflation on the cost of new plant, the allocation has grown at an unexpected rate and this has produced a disproportionate increase in the contribution from long distance to local service.

As the separations process shifted an increasing proportion of the common facility costs to long distance service, other parties became interested in and began to provide interstate long distance service to business customers at a more attractive price. These new entrants provide service to business and high use customers at a more attractive price because the FCC has not required them to bear the same responsibility, i.e., contribute to the cost of local service.

At about the same time, the confluence of computer and communications technology caused the FCC to reexamine the prohibitions against telephone company participation in data processing that were established almost a decade earlier. In May, 1980, the FCC issued its first of three orders (the Second Computer Inquiry, or "Computer II"), which found that the public interest would be best served by competition, rather than regulation, in the enhanced services (i.e., network services which alter the code or protocol of communications) and terminal equipment (or CPE) markets. Accordingly, effective January 1, 1983 the provision of new CPE and enhanced services by telephone companies was deregulated and the investment in such equipment was removed from the regulated rate base.

The Computer II decision also precipitated a change in the separations process. Since part of the investment in CPE is allocated to interstate toll in the separations process, the deregulation of CPE required new procedures to eliminate that allocation. In February, 1982, the FCC adopted a plan, which commenced on January 1, 1983, to eliminate the investment and certain related expenses in CPE from the separations process at the rate of 1/60th per month. This will presumably permit a uniform and gradual transition over five years. At the time this plan was adopted, the FCC recognized that the loss of this source of toll revenues, which heretofore provided a contribution to local service, must be recovered in the future through increases in the cusumers local rates.

Recent Pricing Decisions

As the separations process allocated greater proportions of the common facility costs to long distance service, business customers, who use long distance service to a greater extent than residence customers, were found to bear more of the contribution. These increasing costs for business customers generated great concern among some regulators, legislators, and telephone companies as other parties began to offer long distance service. There was concern that unless business service was based on cost, and its historical support of residential rates reduced, then the business customer would seek alternative telecommunications services and bypass the traditional telephone network. The question was whether bypass constituted a major threat to universal telephone service, since the loss of a substantial amount of revenues from large customers would mean that telephone companies would have to recover more of their fixed costs from remaining customers. In order to avoid such a dramatic (and non-phased) shift of costs to local customers, it was suggested that there would have to be an increase in local service rates to recover a portion of the cost of providing that service in order to allow business and long distance service rates to decrease to a level closer to their costs.

Access Charges

Given the introduction of competition in CPE and enhanced services and their subsequent deregulation, and given that economic theory and economic conditions dictated that residential customers should bear more of the costs of the local loop, the FCC adopted an interstate Access Charge Plan on February 28, 1983, which will be implemented over a seven-year period commencing January 1, 1984. The objective of the plan is to eventually recover from all local telephone consumers, on a flat rate (rather than usage) basis, all of the costs of the jointly used local loop allocated to interstate toll service.

In the first year, telephone companies are required to recover approximately half of these costs from customer charges (about $4 per customer per month on a national basis), by assessing flat rate charges of at least $2 to residence and $4 to business customers. The balance of the costs, paid by interstate long distance carriers, will be shifted to the consumers at the rate of 20% a year during the transition, except for a Premium Access Charge (of 1.4B) to be paid by AT&T (and phased-out over four years), and a Universal Service Fund to provide needed subsidies (at levels to be determined) to high-cost companies. At the end of the transition period, it is contemplated that access charges will be the same for both business and residence customers (Exhibit #4).

The Impact of Change

During periods of significant change, a positive response is required if progress is to be made.

The Washington Utilities and Transportation Commission ("Commission") has shown an active concern for the state's telephone consumers and is working to develop positive responses to the changes that are apparent for the telephone industry in Washington state. It has encourged extensive discussion on a formal and informal basis of major trends and topics and it has not avoided or ignored the difficult issues.

WITA is also responding to the challenges of change. As early as December, 1980, WITA at the Commission's Request, prepared a study of the effects of competition on telephone ratepayers in Washington state. Since then WITA has continued to closely monitor the issues and ramifications of competition, deregulation and access charges and has actively participated in all hearings and forums conducted by the Commission addressing deregulation and its implications.

Recently, the Commission used its good offices to convene a task force consisting of WITA members and Pacific Northwest Bell ("PNB") to determine the actual nontraffic sensitive plant ("NTS") revenue requirements for each telephone company providing service in Washington state.

Based on the preliminary data in this study, if all of the 1981 NTS revenue requirement for each access line were borne by the consumer, then the subscribers of the Asotin Telephone Company would have had to pay, each month, charges of $47.76 (which would have been the highest NTS revenue requirement in the state) and the subscribers of the Ellensburg Telephone Company would have had to pay, each month, charges of $18.92 (which would have been the lowest NTS revenue requirement in the state). The following depicts a monthly range of NTS revenue requirements in the state for 1981, the number of companies within each range and the number of access lines affected:[1]

Monthly NTS Rev. Req.	No. of Companies	Access Lines
$16-19	1	12,556
20-23	2	1,525,194
24-27	6	456,356
28-32	4	47,278
33-36	4	47,836
37 +	2	4,696

As noted, the study also took into effect the phase-out of CPE and inside wire. As a result, the NTS revenue requirement decreases over the transition period as reflected in Exhibit 5. The 1989 end user charge is the actual amount the consumer will pay for NTS. Prior to 1989, during the transition, a portion of the NTS revenue requirement will be covered from other sources. In addition to the NTS revenue requirement, it is necessary to remember that the consumer will also be required to pay for local usage and to provide his/her own CPE.

Beginning in 1984, the NTS revenue requirement will be shifted to the end user over a five year period. Using 1981 data and assuming a flat charge of $4 per access line and a carriers' carrier charge of $0.04 per subscriber line usage minute of use, the average shift to the consumer in 1984 will be

---

[1] For this study, the following assumptions were made:

A. Excludes Cat 6 - COE (if CAT 6 property were included in the NTS Revenue Requirement, an additional $2-4 per month would have to be added to consumers' access line charges).

B. Includes CPE phase-out beginning 1-1-83 for 5 years - through sales and depreciation.

C. Includes inside wire phase-out beginning 1-1-84 for 5 years - through depreciation.

D. All data based on 1981 dollars - no projected growth or inflation.

E. Employed 1981 data since it was last year in which majority of cost studies had been completed.

$5.09. However, customers of seven companies[2] will see their end user charges increase more than 100% in 1984 and the customers of five other companies[3] will experience increases of 50% or more in their end user charges (Exhibit #6). The following indicates a monthly range of end user increases in 1984, the number of companies which will require such increase and the number of access lines affected.

1984 Monthly End User Increases	# of Companies	Access Lines Affected
Less than $1	2	1,525,253
2 +	3	17,881
3 +	3	452,053
6 +	6	49,004
7 +	1	43,142
8 +	3	3,607
10 +	1	3,924

To more fully appreciate this NTS revenue requirement shift, the following projects how the shift will impact customers of several telephone companies during the five year transition period:

---

[2] Continental, Hood Canal, Mashell, Peninsula, Pioneer, St. John and Toledo

[3] Lewis River, Pacific Telecom, Tenino, United, Western Wahkiakum

PACIFIC NORTHWEST BELL - 1,521,340 Access Lines

	1981	1984	1985	1986	1987	1988	1989
Tot. NTS Rev. Requirement	22.30	20.46	18.63	16.80	14.98	13.61	13.16
Interstate ECA Pool	6.72	2.17	1.62	1.08	.53	.13	.00
State Carrier Chg. Rev.	1.94	4.08	3.27	2.45	1.63	.82	.00
End User Charge Interstate	.00	4.00	3.99	3.99	3.98	3.97	3.97
End User Charge State	13.64	10.21	9.75	9.29	8.83	8.69	9.19
Total End User Charge	13.64	14.21	13.74	13.28	12.81	12.66	13.16

UNITED TELEPHONE COMPANY OF THE NORTHWEST - 43,793 Access Lines

	1981	1984	1985	1986	1987	1988	1989
Tot. NTS Rev. Requirement	35.48	32.00	28.82	25.63	22.45	20.21	19.56
Interstate ECA Pool	14.41	9.00	6.92	4.84	2.75	1.05	.00
State Carrier Chg. Rev.	13.61	9.09	7.27	5.45	3.63	1.82	.00
End User Charge Interstate	.00	4.00	4.79	5.58	6.37	7.16	7.95
End User Charge State	7.45	9.91	9.84	9.77	9.69	10.18	11.61
Total End User Charge	7.45	13.91	14.63	15.35	16.06	17.34	19.56

ELLENSBURG TELEPHONE COMPANY - 12,556 Access Lines

	1981	1984	1985	1986	1987	1988	1989
Tot. NTS Rev. Requirement	18.92	16.78	15.05	13.32	11.58	10.49	10.26
Interstate ECA Pool	5.63	.99	.66	.34	.01	.00	.00
State Carrier Chg. Rev.	8.12	8.22	6.58	4.93	3.29	1.64	.00
End User Charge Interstate	.00	4.00	3.81	3.62	3.43	3.24	3.05
End User Charge State	5.18	3.57	4.00	4.43	4.85	5.73	7.21
Total End User Charge	5.18	7.57	7.81	8.05	8.28	8.97	10.26

PENINSULA TELEPHONE & TELEGRAPH COMPANY - 3,924 Access Lines

	1981	1984	1985	1986	1987	1988	1989
Tot. NTS Rev. Requirement	38.92	35.13	32.10	29.07	26.03	24.14	23.76
Interstate ECA Pool	13.58	8.25	6.34	4.42	2.51	.99	.00
State Carrier Chg. Rev.	17.17	8.60	6.88	5.16	3.44	1.72	.00
End User Charge Interstate	.00	4.00	4.86	5.71	6.57	7.43	8.29
End User Charge State	8.17	14.28	14.02	13.77	13.51	14.00	15.47
Total End User Charge	8.17	18.28	18.88	19.48	20.08	21.43	23.76

The Future of Universal Service

The Commission and the industry have attempted to quantify the ramifications of regulatory changes during the past few years on our customers. It is obvious that dramatic increases in rates are going to occur in the next twelve months and that substantial increases will also occur during the remaining portion of the transition period.

We do not appear before you today seeking special assistance, for we realize many of you serve constituents in areas which will experience similar increases. Our desire, like yours, is to protect to the greatest extent possible, the concept of universal service. We know that the changes which have occurred will benefit some of our customers. However, other customers will face rates which they may not be able to pay. This will obviously affect the traditional concept of universal service in high cost areas. Fortunately, the impact on rural telephone consumers is not being ignored. This Committee, our Commission, and WITA are addressing this impact.

We are returning to Washington state and will continue to operate our companies in a most efficient manner, work closely with our state Commission to address and properly implement the necessary changes and strive to educate and prepare our customers for the future. We feel this approach and appropriate assistance for the high cost rural areas will protect most of our consumers and your constituents.

Thank you.

Jon C. Erickson
Vice President & General Manager
Peninsula Telephone & Telegraph Company
P.O. Box 90
Forks, Washington 98331
(206) 374-6212

David D. King
President
United Telephone Company of
the Northwest
Hood River, Oregon 97031
(503) 386-0222

THE INDEPENDENT TELEPHONE COMPANIES OF WASHINGTON STATI

1. **ASOTIN TELEPHONE COMPANY**
Asotin, WA 99402
(509) 243-4111

2. **CONTINENTAL TELEPHONE OF THE NORTHWEST**
Bellevue, WA 98004
(206) 453-2000

3. **COWICHE TELEPHONE COMPANY**
Cowiche, WA 98923
(509) 678-4111

4. **ELLENSBURG TELEPHONE COMPANY**
Ellensburg, WA 98926
(509) 925-1425

5. **GENERAL TELEPHONE OF THE NORTHWEST**
Everett, WA 98206
(206) 258-5321

6. **HAT ISLAND TELEPHONE COMPANY**
Langley, WA 98260
(206) 444-6878

7. **HOOD CANAL TELEPHONE COMPANY**
Union, WA 98592
(206) 898-2481

8. **INLAND TELEPHONE COMPANY**
Roslyn, WA 98941
(509) 649-2211

9. **INTER-ISLAND TELEPHONE COMPANY**
Friday Harbor, WA 98250
(206) 378-2177

10. **KALAMA TELEPHONE COMPANY**
Kalama, WA 98625
(206) 673-2755

11. **LEWIS RIVER TELEPHONE COMPANY**
LaCenter, WA 98629
(206) 263-2191

12. **MASHELL TELEPHONE COMPANY**
Eatonville, WA 98328
(206) 832-6161

13. **McDANIEL TELEPHONE COMPANY**
Salkum, WA 98582
(206) 985-2111

14. **PENINSULA TELEPHONE & TELEGRAPH COMPANY**
Forks, WA 98331
(206) 374-6212

15. **PIONEER TELEPHONE COMPANY**
Lacrosse, WA 99143
(509) 549-3511

16. **PRESCOTT TELEPHONE & TELEGRAPH COMPANY**
Roslyn, WA 98941
(509) 649-2211

17. **ST. JOHN TELEPHONE COMPANY**
St. John, WA 99171
(509) 648-3322

18. **TELEPHONE UTILITIES CORPORATION***
Ilwaco, WA 98624
(206) 642-2311

19. **TENINO TELEPHONE COMPANY**
Tenino, WA 98589
(206) 264-2915

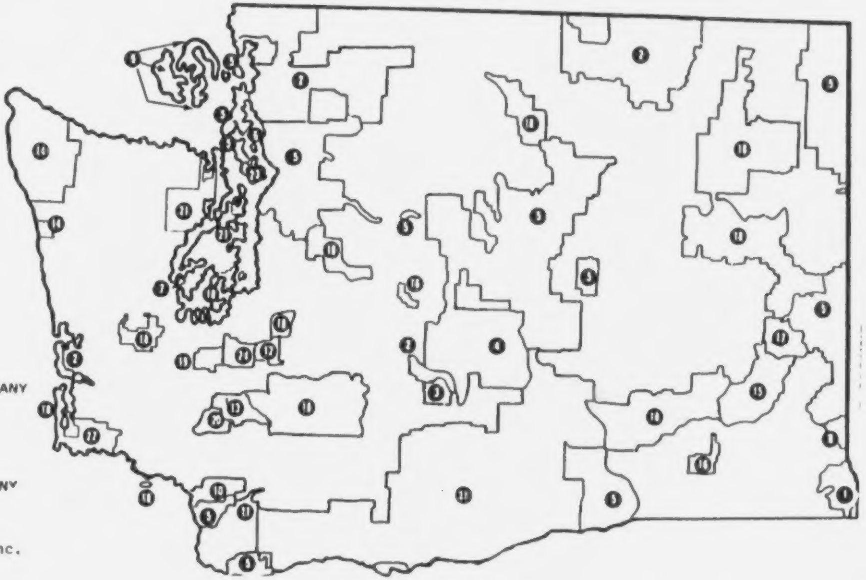
20. **TOLEDO TELEPHONE COMPANY**
Toledo, WA 98591
(206) 864-4552

21. **UNITED TELEPHONE OF THE NORTHWEST**
Hood River, OR 97031
(503) 386-2211

22. **WESTERN WAHKIAKUM TELEPHONE COMPANY**
Grays River, WA 98621
(206) 465-2211

23. **WHIDBEY TELEPHONE COMPANY**
Langley, WA 98260
(206) 321-1111

24. **YELM TELEPHONE COMPANY**
Yelm, WA 98597
(206) 458-2171



*Name changed to Pacific Telecom, Inc.

EXHIBIT 2

WASHINGTON STATE TELEPHONE COMPANIES

Company	Access Lines
Asotin Telephone Company	772
Continental Telephone of the Northwest	43,142
Cowiche Telephone Company	1,341
Ellensburg Telephone Company	12,556
General Telephone of the Northwest	387,603
Hat Island Telephone Company	34
Hood Canal Telephone Company	597
Inland Telephone Company	654
Inter-Island Telephone Company	3,913
Kalama Telephone Company	1,471
Lewis River Telephone Company	1,823
Mashell Telephone Company	1,389
McDaniel Telephone Company	2,072
Pacific Northwest Bell	1,521,340
Pacific Telecom, Inc.	62,627
Peninsula Telephone & Telegraph Company	3,924
Pioneer Telephone Company	778
Prescott Telephone & Telegraph Company	889
St. John Telephone Company	610
Tenino Telephone Company	1,618
Toledo Telephone Company	1,276
United Telephone of the Northwest	43,793
Western Wahkiakum Telephone Company	829
Whidbey Telephone Company	5,024
Yelm Telephone Company	3,854

EXHIBIT 3

JOINTLY USED, OR COMMON, TELEPHONE FACILITIES

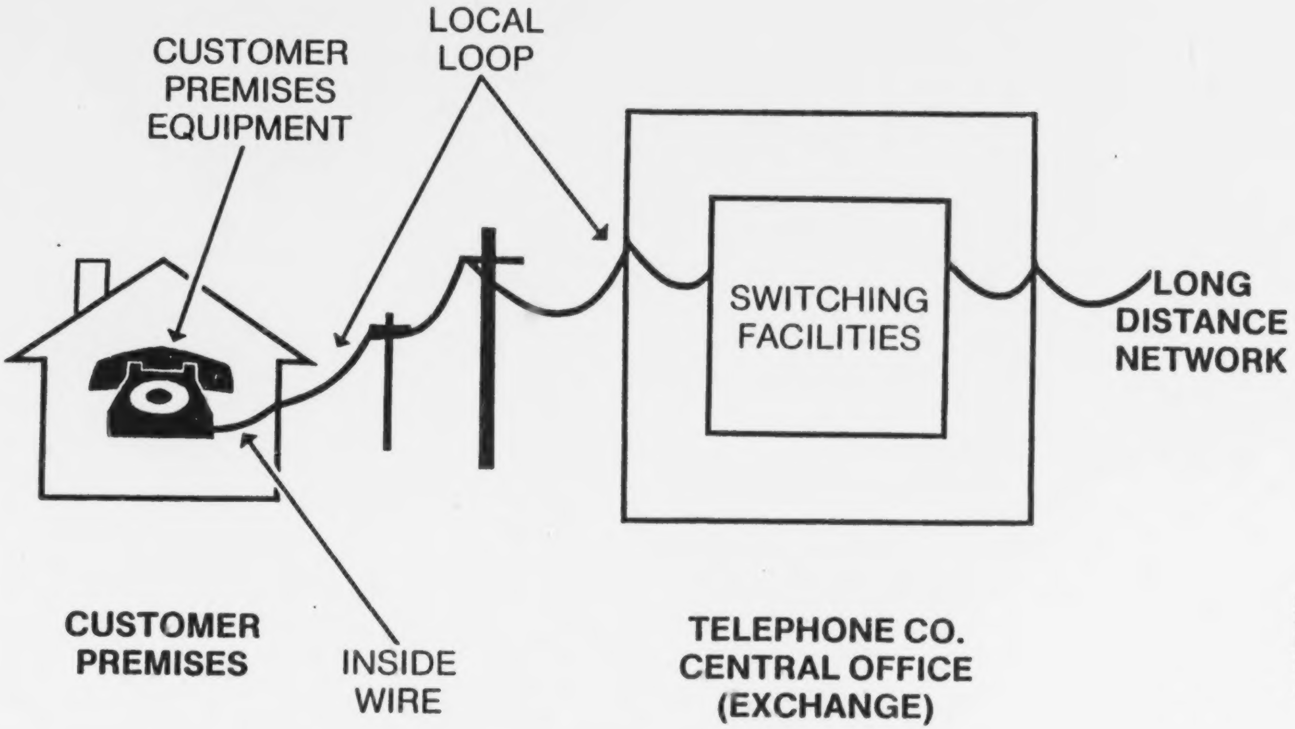

CUSTOMER PREMISES EQUIPMENT
LOCAL LOOP
SWITCHING FACILITIES
LONG DISTANCE NETWORK
CUSTOMER PREMISES
INSIDE WIRE
TELEPHONE CO. CENTRAL OFFICE (EXCHANGE)

EXHIBIT 4

FCC ACCESS CHARGE PLAN

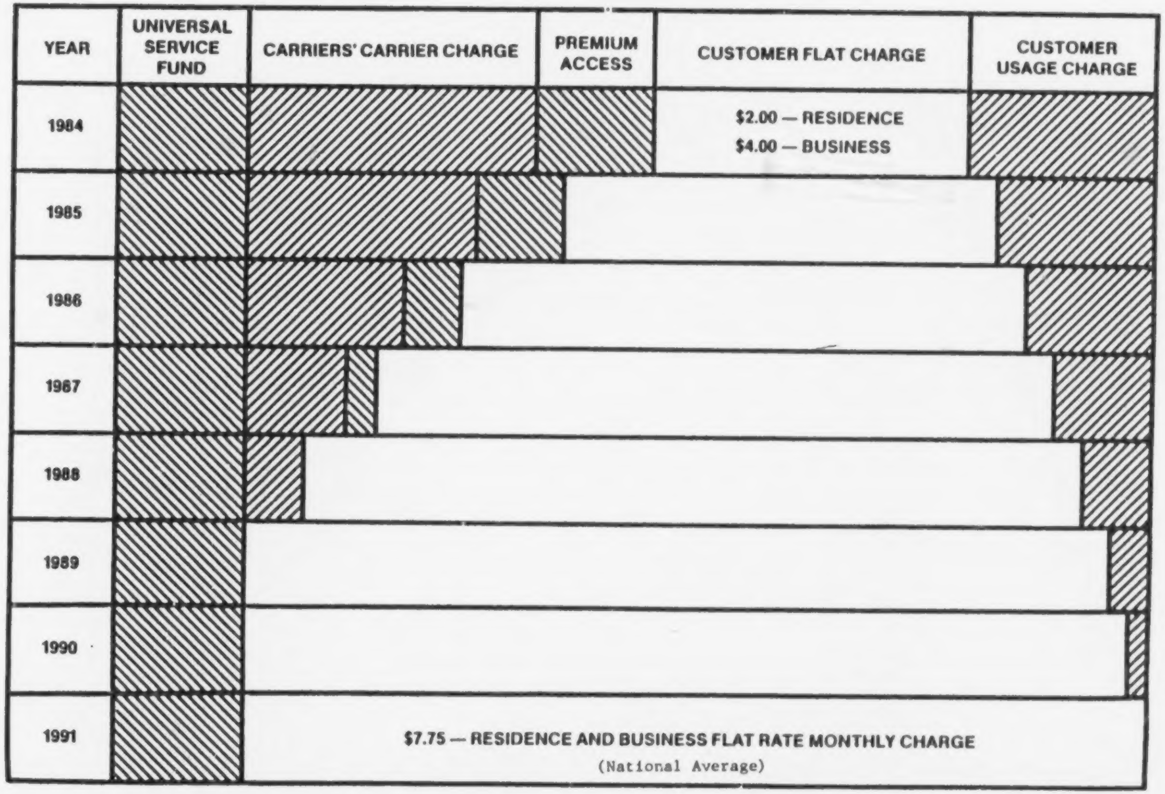


EXHIBIT 5

TOTAL COMPANY ACCESS LINE REVENUE REQUIREMENTS PER MONTH

	1981	1984	1985	1986	1987	1988	1989
Asotin	47.76	45.85	44.04	42.23	40.42	39.12	38.71
Continental	28.44	25.88	23.89	21.91	19.92	18.72	18.51
Ellensburg	18.92	16.78	15.05	13.32	11.50	10.49	10.26
General	26.19	23.70	21.35	18.99	16.63	14.93	14.41
Hood Canal	35.09	32.63	30.76	28.88	27.01	25.89	25.72
Inter-Island	24.28	22.60	20.94	19.27	17.61	16.37	15.97
Kalama	28.84	25.31	22.70	20.10	17.49	15.99	15.80
Lewis River	33.18	31.32	29.35	27.37	25.39	23.85	23.30
Mashell	28.91	26.15	24.16	22.18	20.19	19.09	18.98
Peninsula	38.92	35.13	32.10	29.07	26.03	24.14	23.76
Pioneer	25.89	24.14	22.49	20.84	19.18	17.99	17.63
St. John	27.36	24.97	23.30	21.63	19.95	19.06	18.99
Tel Utilities**	26.63	24.65	22.70	20.74	18.78	17.32	16.83
Tenino	33.04	30.77	28.58	26.39	24.20	22.59	22.08
Toledo	28.70	26.10	22.50	22.30	20.40	19.32	19.20
United	35.48	32.00	28.82	25.63	22.45	20.21	19.56
Western Wahk	26.44	24.35	22.77	21.19	19.60	18.67	18.53
Yelm	21.10	19.57	18.27	16.97	15.67	14.81	14.61
PNB	22.30	20.46	18.63	16.00	14.98	13.61	13.16

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*Three companies were not included since they are still developing 1981 data. Two average schedule companies also excluded.

**Name changed to Pacific Telecom, Inc.

EXHIBIT 6

TOTAL END USER CHARGES IF CARRIER'S CARRIER CHARGE IS $0.04/ SUBSCRIBER LINE USAGE MINUTES OF USE

	1981	1984	1985	1986	1987	1988	1989
Asotin	25.89	34.37	34.96	35.55	36.14	37.10	38.71
Continental	7.16	14.64	15.08	15.52	15.96	16.91	18.51
Ellensburg	5.18	7.57	7.81	8.05	8.28	8.97	10.26
General	11.10	14.66	14.28	13.89	13.51	13.56	14.41
Hood Canal	5.61	11.72	14.25	16.79	19.33	22.28	25.72
Inter-Island	4.37	5.12	7.16	9.20	11.25	13.45	15.97
Kalama	5.48	7.61	8.89	10.18	11.46	13.30	15.80
Lewis River	6.64	9.96	12.42	14.88	17.34	20.04	23.30
Mashell	5.78	12.06	13.04	14.03	15.01	16.63	18.98
Peninsula	8.17	18.28	18.88	19.48	20.08	21.43	23.76
Pioneer	5.44	12.24	13.08	13.91	14.75	15.91	17.63
St. John	6.02	14.71	15.20	15.69	16.19	17.27	18.99
Tel Utilities**	5.33	8.54	9.98	11.42	12.85	14.57	16.83
Tenino	7.60	14.12	15.37	16.61	17.86	19.55	22.08
Toledo	8.27	16.58	16.70	16.83	16.93	17.70	19.20
United	7.45	13.91	14.63	15.35	16.06	17.34	19.56
Western Wahk	7.37	14.20	14.78	15.35	15.93	16.96	18.53
Yelm	4.43	6.77	8.14	9.50	10.86	12.52	14.61
PNB	13.64	14.21	13.74	13.28	12.81	12.66	13.16

---

*Three companies were not included since they are still developing 1981 data. Two average schedule companies also excluded.

**Name changed to Pacific Telecom, Inc.

S. Hrg. 98-382

LOCAL TELEPHONE RATES

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

LOCAL TELEPHONE RATES

AUGUST 29, 1983

Serial No. 98-36

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Committee on Commerce, Science, and Transportation

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of the independent telephone companies in the State of Washington. We believe that universal service can be preserved if Congress will act. We support Senator Packwood's bill, and we urge that the Senate proceed with a sense of urgency to pass legislation before January 1.

[The statement follows:]

STATEMENT OF JON C. ERICKSON, VICE PRESIDENT AND GENERAL MANAGER, PENINSULA TELECOM

My name is Jon Erickson. I am General Manager of Peninsula Telecom. Peninsula Teleco is a small, independent telephone company serving the western half of Clallam and Jefferson Counties. Our operating territory encompasses approximately 2,000 square miles. We serve approximately 3,850 customers from five (5) exchanges located in the communities of Forks, Clallam Bay/Sekiu, Neah Bay, Beaver, and Clearwater. Our operating territory can be characterized as rural, rugged and remote. Telephone communications are extremely important to our customers for economic, social and public walfare reasons.

The effects of recent FCC decisions and the split of the Bell System will significantly affect our customers, as it will all of rural America. As a small, independent telephone company, we are extremely concerned about the impact of deregulation on our customers. We are concerned that the FCC access charge decision and possible implementation of a state access charge system could well make basic service unaffordable to some of our customers. We are concerned that the FCC access charge decision could threaten the availability of universal service to many American households. We believe universal service has been an important national policy and it should continue to be a viable and important national policy goal in the future. Unfortunately, the FCC access charge decision threatens that national policy goal.

Peninsula Telecom has consistently opposed the FCC Access Charge decision, and we continue to oppose it. We support legislation which would reverse the FCC Access Charge Plan. As deregulation unfolds, we see it as a strategy of well organized, well financed and politically powerful large companies to gain economic advantages at the expense of smaller residential and business consumers.

ACCESS CHARGES

Peninsula Telecom believes the FCC access charge mandate is inequitable in that it places the full cost of "access" to the long distance network on the end user. We maintain that a system of access charges which places a reasonable share of the cost of maintaining the local phone system on all long distance companies to be more equitable. Without the benefit of the local loop, long distance carriers cannot provide their customers access to virtually everyone in America. By requiring all long distance carriers to pay for access to local telephone line, they will assist in keeping local rates affordable and preserve universal service.

We would ask, "Why should all customers pay for access to the long distance network when, in fact, a large number of residential and business customers never or seldom use the long distance network?" A study [1] (see Exhibit A) completed by a telephone industry task force indicates that 15.5 percent of residential users and 14.1 percent of business users make no interstate long distance calls during an average month. Moreover, 50.7 percent of residential customers have an average monthly billing for interstate long distance of $2 or less in an average month. Likewise, 42.6 percent of business customers make $2 or less in interstate long distance calls in an average month. Looking at long distance usage another way by examining the percentage of total long distance revenues versus the percentage of total customers, we find only 16.1 percent of residential customers place 64.3 percent of total interstate long distance residential billing, while only 12.8 percent of business customers place 84.6 percent of the total interstate long distance business billing.

Peninsula Telecom recently made a study of customers' long distance usage. We found 9 percent of our small business users made no long distance calls and 5 percent of our residential customers made no long distance calls at all during an average billing month. Furthermore, we found that 19 percent of business and residential customers made $6 or less per month in long distance calls. (See Exhibit B.)

---

[1] The Dilemma of Telecommunications Policy," a preliminary inquiry into the state of domestic telecommunications by a telecommunications industry task force.

It is clear to Peninsula Telecom that a significant percentage of residential and business customers place few, if any, long distance calls. We would ask, why should all customers pay for access to the long distance network when, in fact, a large number of residential and business customers never or seldom use the long distance network? Is an access charge system as mandated by the FCC equitable to the majority of residential and business telephone consumers?

In the continuing debate on access charges, proponents of access charges point out that competition will drive long distance rates down and thereby ameliorate the impact of access charge rate increases. We disagree. When so few residential and business customers use interstate long distance service, how will even a large decrease in interstate rates balance the expected access charge increases? The answer, we believe, is obvious—it won't.

TOLL DE-AVERAGING

Consideration also must be given to the impact of intrastate toll rates. Many industry observers believe that state toll rates will be "de-averaged". If state toll rates are de-averaged, it is fair to assume that many short haul toll routes serving rural areas will realize long distance rate increases, not decreases. This is true because toll routes in rural areas are generally lower volume, higher cost routes than those routes between larger cities and suburbia. When and if toll rates are de-averaged, the residential and small business consumer will not only be forced to inequitably pay for long distance access but also will pay higher long distance rates.

ESTIMATED ACCESS CHARGES

Peninsula Telecom has made estimates of how much its customers' local rates could increase due to the FCC's Access Charge decision, and estimates also have been made for all Washington State telephone companies. We have reason to believe our one-party residential rate for rotary service could increase from $8.74 to as high as $25.30 by 1989. That's a 190 percent increase. That increase is exclusive of inflation and any network access line increases. If inflation were considered at 5 percent, the Peninusla Telecom one-party residential rate could increase by 214 percent by 1989. The percentage increases for other Washington telephone companies could range higher than 300 percent. (See Exhibit C.)

DEMAND ELASTICITY

There is disagreement on the effect of significant rate increases on the demand for telephone service. Regardless of this, there have been demand elasticity studies made. Lester d. Taylor, in his book [2], reviews eight demand elasticity studies conducted between 1971 and 1978. The most quoted of all demand elasticity studies made is that of Dr. Lewis J. Perl, Vice President, National Economic Research Associated, Inc.[3] Dr. Perl found that the demand for basic service is significantly influenced by both the monthly service charge and the service connection charge. Furthermore, Dr. Perl found price elasticity of demand is quite sensitive to the level of household income and to the age of household. Moreover, Dr. Perl found that regardless of the demographic group considered, the biggest impact on price increase of telephone service is on the young, black, and rural demographic sub-groups.

Reviewing the demand elasticity studies must lead one to the conclusion that the demand for telephone service is highly price inelastic. If that assumption is accepted, then there should be genuine concern for the survivability of universal service in the FCC access charge environment.

During the last 3½ years, Peninsula Telecom has lost 6.7 percent of its network access line customers. Because of economic conditions in our area, we initially believed the customer loss was due to people moving from the area to look for work elsewhere. Recently, we began an onging analysis (Exhibit D) of the reasons why customers were disconnecting from our system. The results of that analysis were eye opening to us. During a four (4) month period (April 1, 1983 to August 1, 1983), 171 customers disconnected from our network. Of that total, 86 customers—or 50 percent—disconnected and moved from the area, 40 customers—or 24 percent—were disconnected for non-payment of delinquent accounts, and 45 customers—or 26 percent—voluntarily disconnected but continued to live in our operating territory. We believe the fact that 26 percent of all customers who disconnected did so voluntarily is good evidence they did so because price of telephone service versus discretionary income was a deciding factor. We believe this phenomenon (voluntary disconnect) could well repeat itself when significant rate increases occur because of access charges.

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[2] Lester D. Taylor, "Telecommunications Demand: A Survey and Critique" (Ballinger Publishing Company, 1980).

[3] Dr. Lewis J. Perl, "Economic and Demographic Determinants of Residential Demand for Basic Telephone Service" (National Economic Research Association, Inc., March 28, 1978).

It should be pointed out that on August 1, 1982, a general rate increase was put into effect as approved by the Washington Utilities and Transportation Commission. That rate increase was an average 52 percent. The rate increase could have affected the decision for voluntary disconnects. Another rate increase of 32½ percent was effective August 1, 1983. We are continuing our survey of disconnecting customers to determine if the voluntary disconnect trend continues.

There are other documented cases which suggest a strong correlation between telephone rate increases and customer drop-off. One such case is that of Hickory Telephone Company, described in testimony presented before the House Telecommunications Subcommittee on March 22, 1983. Hickory raised is local rates in 1975 from $10.66 to $16.35, a 54 percent increase. Consequently, 14 percent of the customers discontinued their basic telephone service.[4] In another case, the Big Run Telephone Company in Pennsylvania requested and received approval for a substantial local rate increase to cover the costs of purchasing some used switching equipment. Approved in April, 1981, the new rate was an increase of about 40 percent, to a total of $21.75. Within several months, 22 percent, or 204 of the system's 924 subscribers, dropped service.

Peninsula Telecom believes that demand elasticity studies and the experience of our company, Hickory Telephone and Big Run Telephone are evidence that the FCC Access Charge Plan could well be the beginning of the silencing of rural America.

LEGISLATION

Peninsula Telecom supports legislation to preserve Universal Service. Universal Service can be preserved if Congress will act. A good start would be to reverse or stay the FCC Access Charge System. Peninsula Telecom believes the following principles should guide national telecommunications policy: "(1) all providers of telecommunications services, including bypassers of local facilities, should contribute equitably to the costs of providing local telephone service; (2) a Universal Service Fund to deal adequately with telephone service in high cost areas must be developed; (3) consistent and uniform regulatory policies between federal and state jurisdictions should be implemented; (4) end users should not pay directly for the costs of the local telephone lines; and (5) toll connecting links whose costs are significantly higher than the national average should be compensated for by the Universal Service Fund."

We urge the Senate to pass legislation which embodies the above principles and to work cooperatively with the House to approve legislation which will give clear direction to national telecommunications policy.

EXHIBIT A

(Excerpt from "The Dilemma of Telecommunications Policy," and preliminary inquiry into the state of domestic telecommunications by a telecommunications industry task force.)

EXHIBIT 8

TABLE 4.—DISTRIBUTION OF INTERSTATE LONG-DISTANCE BUSINESS BILLING

Average monthly billing	Percent of total—		Cumulative percent of revenues
	Customers	Revenues	
0.00	14.1	.0	.0
2.00	28.5	.6	.6
4.00	10.8	.8	1.4
7.00	8.7	1.2	2.5
10.00	5.3	1.1	3.7

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[4] Testimony of Michigan Public Service Commission, Chairman Eric J. Schneidewind before the House Subcommittee on Telecommunication, Consumer Protection and Finance of the Energy and Commerce Committee, March 22, 1983.

TABLE 4.—DISTRIBUTION OF INTERSTATE LONG-DISTANCE BUSINESS BILLING—Continued

Average monthly billing	Percent of total—		Cumulative percent of revenues
	Customers	Revenues	
15.00	6.1	1.9	5.6
20.00	3.7	1.7	7.2
30.00	4.7	2.9	10.2
50.00	5.3	5.2	15.4
100.00	5.2	9.4	24.8
200.00	3.7	13.5	38.3
200.00 +	3.9	61.7	100.0

Mean = $39.31
Excludes Centrex customers and Federal Government

Exhibit 8

TABLE 5.—DISTRIBUTION OF INTERSTATE LONG-DISTANCE RESIDENTIAL BILLING

Average monthly billing	Percent of total—		Cumulative percent of revenues
	Customers	Revenues	
0.00	15.5	.0	.0
0.50	13.8	.6	.6
1.00	9.2	1.3	1.9
2.00	12.2	3.3	5.2
3.00	8.1	3.7	8.9
4.00	6.2	4.0	12.8
5.00	4.6	3.9	16.7
7.50	8.6	9.8	26.5
10.00	5.7	9.2	35.7
15.00	6.5	14.8	50.5
25.00	5.6	19.6	70.1
25.00 +	4.0	29.9	100.0

Mean = $5.39

Exhibit B

MONTHLY BILLING

Toll usage	Business	Residence
$0.00	9	5
$0.00 to $2.00	3	5
$2.00 to $4.00	6	6
$4.00 to $6.00	1	3
$6.00 to $8.00	1	6
$8.00 to $10.00	1	2
$10.00 to $15.00	1	16
$15.00 to $25.00	10	16
$25.00 to $50.00	19	20
$50.00 to $100.00	29	13
$100.00 to $200.00	13	7
$200.00 +	7	1

EXHIBIT C

	Peninsula	St John	Tenino	Toledo	Lewis River	PNB/WA
1984:						
1 FR	8.74	6.00	6.00	6.00	5.00	11.15
Fed CALC	2.00	2.00	2.00	2.00	2.00	2.00
State CALC	2.61	3.78	3.34	3.89	2.62	1.47
Cost of access	13.35	11.78	11.34	11.89	9.62	14.62
Percent	53	96	89	98	92	31
1989:						
1 FR	8.74	6.00	6.00	6.00	5.00	11.15
Fed CALC	6.06	6.72	6.13	6.49	7.83	4.02
State CALC	4.72	5.36	5.21	5.70	5.58	2.26
Res to local	5.78	4.58	6.19	6.64	8.02	
Total	25.30	22.66	23.53	24.83	26.43	17.43
Percent	190	278	292	314	429	56
1984:						
1 FR	8.74	6.00	6.00	6.00	5.00	11.15
Fed CALC	2.00	2.00	2.00	2.00	2.00	2.00
State CALC	2.61	3.78	3.34	3.89	2.62	1.47
Cost of access	13.35	11.78	11.34	11.89	9.62	14.62
Percent	53	96	89	98	92	31
1989:						
1 FR	9.18	7.64	7.64	7.64	6.37	14.21
Fed CALC	6.06	6.06	6.13	6.49	7.83	4.02
State CALC	4.72	4.72	5.21	5.70	5.58	2.26
Res to local	7.44	5.84	7.89	8.46	10.22	
Total	27.40	24.26	26.87	28.29	30.00	20.49
Percent	214	304	348	372	500	84

EXHIBIT D

A survey of network access line customers disconnecting from Peninsula Telecom services. Study period April 1, 1983, through July 31, 1983.

Reason for disconnect	Percent	Number of access line customers disconnecting
Voluntary—stay in area	26	45
Voluntary—left area	50	86
Nonpayment	24	40
Total	100	171

Senator GORTON. Thank you, Mr. Erickson.

Mr. Appelo.

Mr. APPELO. Good morning, Senator Gorton and your friend from Kansas there, Ward White. I worked with him on telephone legislation for many years.

My name is Carlton Appelo. I have served as general manager of Western Wahkiakum County Telephone Co., for the past 31 years. I presently serve on the board of directors of USITA and the National REA Telephone Association, and was the national president of OPASTCO in 1979. But today my testimony is only for myself and the subscribers of our company located here in southwest Washington. I sincerely believe that my opinions are closely in line with others serving rural and small town America. I have been working on national legislation since 1972, to try to get something passed that would be helpful to us in rural America.

Senator Gorton, I am most grateful for the concern shown by you and your committee in analyzing the possible adverse effects of the Federal Communications Commission's orders and directives on telecommunications in America. Most of the media coverage has concentrated on the breakup of A.T. & T. It is general knowledge that the Bell System companies serve 80 percent of the telephones in the United States, while we smaller, non-Bell companies serve about 70 percent of the geography of America.

The company and the territory that I serve certainly qualifies as rural. Our two exchanges at Grays River and Naselle serve 825 main telephones and a population of 2,000 plus. We cover an area 10 miles by 40 miles, requiring a relatively high investment. We have borrowed nearly $2 million from the REA during the past 15 years to bring modern dial service to our customers, and we are putting in a digital switch this year.

This equates to $2,900 per main station. Bell's national density is about 88 per mile, and ours is 4.8 per route mile of outside plant; 79 percent of our revenue comes from toll, and it is going to be extremely difficult when this source dries up, to be replaced by a burden on 825 customers, no matter what they are charged.

We feel that this ultimately will put us in default on our obligations to the REA, and we are not the only ones. There are 940 other REA borrowers owing some $4 billion to the Government. It is a concern to us and to them.

I also feel reasonably qualified to discuss telecommunications in the rural sector because, like many, I grew up in the business. I started at age 10 working on switching a local farmer's line in my father's general store and post office at Deep River. Except for 3 years in the Army and 7 years in college, I have been involved in the business ever since.

I feel I understand the need for reliable service at affordable rates in my community and have a strong sense of responsibility to continue that service to my neighbors. We are a locally owned stock corporation, owned by our customers primarily. There seems to be a strong agreement that if current FCC decisions are allowed to stand, the price of residential telephone service, particularly in rural areas, will skyrocket. Estimates range from a doubling of rates to a redoubling in a 3 to 4 year period. It has been argued, and with some justification, that telephone service has been so good, so cheap, for so long, that it would still be a bargain at twice the price. I am satisfied, however, that even a bargain can be priced out of the market in rural areas, such as ours, where cash income is very limited. What others may consider to be an insignificant amount can really make or break a rural budget.

We have no rich wheat farmers in our area. Fishing is a basket case, while it once was the primary industry. The local logging is suffering severely with the departure of Weyerhaeuser's 194-man payroll in a region with a labor force of under 1,000.

Because of our rural lifestyle, living off the land, with a relatively small cash income has been adequate. However, there is a definite and rising requirement for funds to meet fuel costs, taxes, health care, electricity, and now telecommunications services. It is going to be a real challenge to make ends meet.

A national cost accounting firm study last month, in 22 States among a million customers, indicated that 7.5 percent never made any toll calls, 36 percent never made interstate calls, 12.8 percent made no intrastate toll calls.

Now, we did a study in our own area this month; 15 percent of our residential customers had no interstate toll, and 12 percent had less than $2. This is a total of 27 percent under $2. A small business study indicated that 36 percent of our business customers had no interstate toll, and 17 percent had less than $2. Hence, 53 percent of our business customers had less than $2 a month toll. This compares to our friend George Walker of PNB who testified recently that Pacific NW bills average toll is $22 per phone. This is not typical in rural Washington State.

Now, the FCC and some State commissions propose to assess an access charge to these customers who never use the toll network. It is my studied opinion that universal telephone service, once mandated by Congress, will simply disappear if the proposed access charge is levied on each end user, plus the inevitable local service rate increases generated from normal inflationary pressures.

In our own case, we have had a net operating loss for the past two quarters. We will need a rate increase just on economic need, in addition to the prospective access charge in 1989, of $18.29 per month.

The FCC and other regulators have contended, supported by the new long distance carriers, that local service rates are unreasonably low because of the toll subsidy. I grant that compensation paid to the local systems for the use of their facilities to complete toll calls is a major contributing factor to the financial health of these local companies, so much so, that many companies will not survive without it. However, this settlement process was worked out within the industry and in conjunction with the FCC. It has long been considered fair and equitable by the industry, by the regulators, and the general public. The joint use of local facilities funded by an additive on toll rates has made possible universal service at affordable rates such as Congress dictated back in 1934. It has worked well for the benefit of all concerned, enhancing the ultimate goal of a phone in every household, farm, and small business in America.

Why should this compensation procedure now be discontinued? The bypass bugaboo is addressed in S. 1660.

There is a second gut issue looming on the horizon of rural America, a proposal that long-distance charges be deaveraged, allowing the low usage, low density routes to carry their true cost burden. Benefits would accrue to the competitive high usage routes, Seattle-Chicago, Los Angeles-New York, but like the airline experience, our Grays River-to-Seattle or Tenino-to-Portland rates would rise like a cat's back. Surely it would eliminate all, save absolutely emergency calling between rural and small community points. How could any small business survive and prosper in this environment?

We need a carefully crafted legislative proposal to address this point if we want the infrastructure of rural America to survive.

In summary, I urge Congress to readdress its original mandate of universal service at affordable rates to urban and rural customers across the land. To accomplish that goal, I believe it is essential that specialized carriers continue compensating local carriers for the joint use of local facilities needed to complete a long-distance call. A practical system of separation of costs is in place and working. A surcharge levied equally upon all toll calls will not threaten the new competitive market and it does permit the continuation of a remarkable, complete, and excellent level of telephone service for the entire Nation. It would also avoid silencing a substantial element of residential America.

I thank you very much for your attention and I will be glad to answer any questions about our company or any other items.

Senator GORTON. Thank you, Mr. Appelo.

I think I will ask the first question to both Mr. King and Mr. Erickson. That question is whether or not this panel correctly reflects the differences of opinion on this subject among independent telephone companies. I believe Mr. Erickson stated that 80 percent of the companies are against the FCC decision, which would imply that 20 percent do not want it changed.

Is that correct? If so, what percentage of the actual telephone subscribers in WITA are represented by that 80 percent and what by the 20 percent of those two of you who came out on the other side on this issue?

Mr. KING. Mr. Erickson used that statistic. I will let him answer.

Mr. ERICKSON. Well, my reference to 80 percent, Senator, is from the fact that of the 25-member companies in our State association, or 24-member companies, 4 of the companies are larger holding companies, and in my discussions with people like Mr. King, I think it is fair to say that they are against reversing the FCC access charge decision, and therefore, against the legislation. However, the small companies like Carl Appelo and myself generally agree that we would like to see it reversed.

Now, as to the percentage of customers represented by that 80 percent, I don't have that statistic.

Senator GORTON. It would, I take it, be somewhat closer to even.

Mr. ERICKSON. No; it would not. It would be much, much less than even because when you take General Telephone Co. and United and Pacific Telecom, they serve a large number of customers.

Senator GORTON. Very well. So you have about 70–30 in reverse.

Mr. APPELO. Senator, I think that one must vote his own interests. Larger companies certainly have a stake in the interconnect market themselves, and I think you know the significance of this factor. A large corporation must be able to develop an economic plan. They require a situation that is stable. The way things are moving it is very difficult to plan next year's budget in a period of fundamental change. They must seek stable factors to anchor their long-range plans.

TELEPHONE RATE INCREASES AND THE ELDERLY

HEARING

BEFORE THE

SUBCOMMITTEE ON
HOUSING AND CONSUMER INTERESTS

OF THE

SELECT COMMITTEE ON AGING
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

FIRST SESSION

AUGUST 11, 1983, CHEHALIS, WASH.

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Mr. **Bonker**. We will now hear from another telephone representative, Mr. Peterson of the Tenino Telephone Co.

STATEMENT OF EWART PETERSON

Mr. **Peterson**. Can you hear me back there without the microphone?

Voice. Use the microphone.

Mr. **Peterson**. I am going to read my prepared statement which has been given to the Congressmen, Congressman Bonker and Congressman Wyden, and then I just have a few comments I would like to make that kind of came to me last night that I think should be mentioned.

My name is Ewart Peterson. My family and I own and operate the Tenino Telephone Co. in Tenino, Wash. We serve about 1,800 customers from the Tenino and Bucoda communities, and I have been in the telephone business for 52 years.

In that time, I have been involved in all phases of the business, from night operator, to installer repair, to climbing poles, and to participating in the toll-settlement process.

Providing good service has been and still is my life's work, and I am vitally concerned in behalf of my customers and myself in the changes that are currently taking place in the telephone industry and in its regulation.

I am a member of the Washington Independent Telephone Association, but I do not officially represent that organization in my comments today. I am of the opinion, however, that my views are in general agreement with many other members of that organization.

I have been advised of four areas of the subject of proposed changes in telephone regulation in which you are particularly interested. I would like to address myself to those areas of interest and to offer my comments as to the cause, effect, and possible solutions.

In regard to the effects of current and proposed local rate increases on universal service, and specifically among the elderly, I am of the opinion that reliable and universal, local service is essential to the welfare of the elderly, the ill, and the handicapped. Telephone service is more than a matter of convenience to them. There are occasions when the telephone is a matter of life and death.

My company serves many elderly people with fixed and limited incomes who find our present $6 rate per month charge to be an important part of their budgets.

Intrastate and interstate access charges—that is these charges they are proposing—will come within 60 cents of doubling that rate in just the first year. It is planned that further increases will be effective in 1985 and 1986. The business-access charge will be somewhat higher, but the number of businesses served by my company is minimal and that extra revenue will be of little consequence overall in replacing lost division of toll revenue.

I think it is reasonable to say that those increases must have a very significant, adverse effect on the lives and services of the elderly.

In regard to rate increases, other than proposed access charges, I am pleased to be able to report that 1983 saw the first rate increase of the Tenino Telephone Co. in 20 years, and that increase was a modest 30 percent.

The primary reason for that increase, in addition to inflation, was the requirement that we unbundle, which means that we separate our rates in order to give our customers the option of owning their own telephone sets.

We have no pending rate increases at this time, but when the long-distance carriers—that is the toll people—stop paying for the use of our switching and distribution systems—and that is what this is all about.

They are trying to make you customers pay for what they should pay. When they stop paying for the use of our switching and distribution system, which is essential to the origin and completion of their calls, we will undoubtedly have to apply for increases in local service rates, and that will be over and above the prescribed access charges.

I can't stress enough that this access charge thing is positively evil. It is absolutely unconscionable. It can't be defended in any way.

People may use words to defend it, but morally it is absolutely wrong, I tell you. I am telling you the truth.

Of our current revenue, 65 percent comes from the division of toll revenue based on the separation of costs. It is obvious that being deprived of that revenue will require an increase in local rates or result in a serious deterioration of service, and this applies just as much to Centralia and Chehalis as it does Tenino.

The loss of that long-distance revenue or the division of toll revenue can have another adverse effect that perhaps should have consideration. Like hundreds of other rural and smaller community telephone systems, the Tenino Telephone Co. obtained a substantial portion of its financing from the Rural Electrification Administration. They were set up to see that small towns and rural areas could have just as good telephone services as the big cities, and that is the way it is in it.

It may be pertinent to mention a substantial portion of our finances came from them. It may be pertinent to mention that the investment per station of my company, because it serves a rural area, is substantially above the average of REA borrowers, and it is much higher than the average across the Nation.

To be specific, our investment is $2,132 per telephone, while the average Rural Electrification Administration borrower is $1,863. Those loans and their repayments were predicated on the expectation of a large portion of the revenue coming from the use of the local system by the toll carriers for the completion of long-distance calls. It is ironic and unfortunate that one department of Government, the Federal Communications Commission, should adversely affect the program of another department, the Rural Electrification Administration.

In my opinion, the long-distance revenues that have made universal telephone service available and affordable in the United States are fair and proper, while the formula for determining the division of the long-distance dollar are detailed and complex.

The basic application of cost separations is readily understood and justified. Simplified, it is accomplished by the measurement of local central office minutes of use for local calls and the measurement of minutes of use for long-distance calls to determine the relative minutes of local and long-distance usage.

That relative usage is then applied to the cost of the local system, and the revenues are divided accordingly. It is a fair and reasonable approach arrived at through mutual negotiation over the years of trial, and it has served the industry and the Nation remarkably well. It recognizes that local and long-distance service can and should go hand in hand.

New technologies and deregulation have introduced competition into the provision of long-distance service, for better or for worse. It has not changed the fact that the local service facilities are an essential part of the long-distance service.

Long-distance access charges, intrastate and interstate, against the local-service ratepayer on a flat-rate basis, whether or not he ever makes a long-distance call, have been proposed to substitute for the long-distance users' payment for the use of the local facilities. I believe this to be preposterously unfair. In my opinion, it is totally and absolutely wrong.

I suggest that a charge be placed on all long-distance carriers or calls that will permit for the long-distance carriers will pay—permit payment for the use of the long-distance carriers' use of the local system facilities.

It would not be detrimental in any way to the competitive aspects of long-distance service because they would all be paying it, and it would eliminate the necessity for an access charge.

Furthermore, it would permit payment to the local telephone company for the use of its system in the completion of long-distance calls.

As you can see, I entirely disagree with my friend here—and George Walker is my friend. I have been in the business many years.

I dealt with his father. His father worked all his life with Pacific Northwest Bell, and George is my friend.

If I may just make a few comments off the top of my head. It is mentioned here that—I would like to just say this: my testimony comes from my heart, it does, it comes from my heart in an effort to save my customers.

This arrangement of access charges is deadly to our customers. It just simply cannot be defended. I am not paid for my testimony.

I am just telling it like it is, from my heart, and I want another thing to be made clear. "Toll settlements," as the term is used from time to time, is not a subsidy under any conditions. It is a fair and reasonable payment for the use of the local telephone plant for the origination and completion of toll calls.

Now, that went on for years and it served the Nation well. But I tell you, they are going to unload all of this off onto the end user, and that is absolutely wrong.

The planned access charge arrangement—I will try and hurry, Congressman—cannot be morally defended in any way. The toll carriers wanting an access charge placed on the customers really want a free ride at the expense of the local ratepayers.

Ladies and gentlemen, the toll business is where the money is. Don't think for 1 minute that some of the new long-distance companies, and there is many of them that are coming into being—are putting up satellites—that is one of these new technologies that everybody is talking about—are putting up satellites just because they enjoy the fireworks when the rocket goes up; they know where the millions of dollars are.

They know there are millions of dollars to be made in the toll business, and they are going to hang the rigging on the local customers so that they can make more money.

I tell you, I am telling you the truth. I am telling you just like it is. Again, I say the long-distance companies should pay their share of the cost of their use of the local telephone system.

I might also mention that powerful forces are arrayed against any changes in the access charges as they are now being proposed. You know that—just 1 minute. I am sorry. Can I finish?

Lifeline Service sounds like a good deal, but it is not good for the older people. Some companies offer a lower rate of service. My friend, Mr. Walker, said it, which is piously said, in answer to rising prices, but it only allows very few calls and minimal use. It might be useful to call 911 once in awhile, but otherwise it is not of very much value.

My view on local, measured service is that it is not for small towns. I would suggest local, measured service is merely a means of extracting more money out of the subscriber.

In a small telephone system, a flat rate is satisfactory, a small system like ours, because the way our situation is—I got to get on here. In a small system, a flat rate is satisfactory because there is little difference in the cost to the company if a given customer uses his telephone 10 minutes or 2 hours a day.

The older people who supposedly benefit by measured service are the ones who would use their phones the most, to visit and to call neighbors, because they can't get out as much as the young people, as the younger and more mobile people.

So measured service is not the answer for them. Measured service is sold on the basis of so much per minute or something like—just like your electric kilowatts are measured.

Last Sunday morning on the David Brinkley show, Mr. Brown of AT&T and Mr. McGowan of Microwave Communications happen to be on a panel, and they were being introduced. Mr. Brown said a lot of his customers would not benefit from all that is happening.

I certainly agree with him, but he was not going to look back. Well, I am going to look back. I am going to look back and see a great telephone system offering good service at affordable rates.

I am going to look ahead now and I am going—affordable rates to 90 percent of the people in the country. I am going to look ahead and see disaster for Tenino Telephone Co. customers and unless some solution to the present dilemma is found, both Mr. Brown and Mr. McGowan agreed that what was happening was good. I might ask, for what?

A reporter suggested that the toll company should pay an access charge and not the toll users. That is just what I have been talking about.

Mr. McGowan, who is in it, of course, to make money, and I think one of his companies is one of the ones that sent up a satellite—Mr. McGowan was horror-stricken at the idea.

I also think—I am just throwing this in here—there is all this talk about toll rates going down. Well, I notice they talk about a 6 percent decrease, and I will tell you in my honest opinion the toll rate saving, I think, will prove to be illusory.

Anyway, I will just close here by saying it is also deplorable that in this whole thing, from start to finish, whatever it was, 7 years or 10 years ago, the independent telephone companies are never mentioned once.

This whole affair, in closing, is shot through with unelected and unknowledgeable people making decisions affecting our and our customers' very existence. I feel very strongly about this.

Mr. **Bonker**. Doug Owens is the assistant attorney general for the State utilities and transportation commission, and will be our last witness. We will then proceed with questions.

Mr. Owens, thank you for coming down to be with us today.

STATEMENT OF DOUGLAS N. OWENS

Mr. **Owens**. Good morning, Congressman Bonker and Congressman Wyden.

I am glad for sharing some of the lightning for being an attorney with Representative Halsan. But I will proceed with comments on behalf of Commissioner Mary Hall, who was to have been the original speaker this morning.

I understand there is interest in four questions before the subcommittee, and I will try to deal with those. The first one is how will current and anticipated increases in local telephone rates affect the universality of service, specifically among the elderly. Related to that is, how will those increases affect organizations servicing the elderly.

You have heard a lot of discussion already this morning, and I think it is fair to say that the answer to the first question really depends on how these increases are dealt with. It is true that under the new environment that has been determined at the Federal level, there are costs which are no longer to be collected in the long-distance rates that each of us as consumers pay.

But how those are dealt with at the local level can impact the answer to the question of how they affect universality of service among the elderly.

You have heard proposals or indications that are proposals for waiving these charges for specific classes of customers and those are under consideration.

There are possibilities of financing a universal fund which would be available to offer payments to offset these increases. At the outset, I think we have to recognize that it is not a settle question, that any of the number of us that have been calculating, and after some effort, necessarily means specific increases to individual consumers.

There is some disagreement - as you have heard already this morning between the proper way to deal with the necessity to

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ACCESS CHARGES AND THE RURAL DILEMMA

Jon C. Erickson
Peninsula Telephone and Telegraph Company

My comments regarding access charges and FCC Docket 78-72 are from the frame of reference as general manager of a small rural telephone company, a company which has a high non-traffic sensitive investment similar to many companies serving rural America, a company which serves 3,850 network access lines in an operating territory which covers over 2,000 square miles. My comments are influenced by my concern for the rural residential and small business telephone consumer and high exchange access rates facing them in the future. My viewpoint is narrow, but that is appropriate, since the FCC's approach to access charges is driven by blind adherence to an overly narrow economic rationale which seemingly ignores the practical impacts on residential and small business consumers in high cost exchange areas, a rationale which concerns itself only with economic and social benefits to be gained from universal service without impairing economic efficiency and competition.

My viewpoint is biased by the observation that the rural consumer has not been adequately represented in the public policy debate to forumlate the new era of telecommunications policy. The telephone consumer today remains generally uninformed, confused, and unaware of the impending impact to be caused by Docket 78-72 and related FCC decisions.

Today I will address four questions concerning access charges and Docket 78-72 as I perceive its effect on rural consumers in high cost areas. The questions are:

1. Does the access charge plan in Docket 78-72 eliminate the objections of PURE 2 for rural high cost exchanges?

2. What is the possible impact of the access charge plan in Docket 78-72 on exchange network access line rates for rural telephone consumers in high cost exchanges?

3. Does the access charge plan in Docket 78-72 adequately protect the Universal Service concept for rural America?

4. Assuming the FCC access charge plan remains unaltered and is mirrored at the state level, are there alternatives open to State Regulators to lessen the impact of Docket 78-72 on high cost exchange areas?

My response to the above four questions assumes that, even though state commissions would not be required under a preemption requirement to adopt all or any part of Docket 78-72, it seems inevitable states will adopt similar plans if for no other reason than the desirability of a uniform approach and also that dominant carriers want it. I have also assumed, in response to the second question, that you cannot just look at the effect of Docket 78-72 when measuring the impact on consumers in high cost exchanges. Realistically, the impact of other deregulation changes which impact rates must also be considered changes such as the expensing of station connections, deregulation of station apparatus and depreciation changes.

Question 1: Does the access charge plan in Docket 78-72 eliminate the objections of PURE 2 for rural high cost areas?

The transitional period does soften the impact of the access charge plan on rural consumers' rates, but the transitional period reminds me of the medical axiom called Miller's Law which says, "All bleeding will eventually stop." Under the access charge plan, the rural bleeding stops in 1991.

If you examine the recovery of non-traffic sensitive costs by telephone companies over the transition period, it appears to me you end up with essentially PURE 2. From a rural frame of reference, the access charge plan would be liveable in 1984; if fact, it probably isn't too bad through 1987. Beyond 1987 it looks bleak for high cost rural exchanges, since by 1991 the end user pays the overwhelming percentage of non-traffic sensitive costs.

The major difference between PURE 2 and the access charge plan in Docket 78-72 is the transitional period and the Universal Service Fund of an estimated $500-600 million. Until the Joint Board determines the makeup of the high cost factor, it is difficult to determine the extent of subsidy available to high cost exchange areas from the Universal Service Fund.

The only hope for the rural consumer is an adequate Universal Service Fund. Absent an adequate fund, Docket 78-72 does not eliminate the objections of PURE 2 for high cost exchange areas.

Question #2: What is the possible impact of the access charge plan in Docket 78-72 on exchange network access line rates for rural telephone consumers?

To my knowledge the FCC has not collected the data necessary to analyze the impacts of Docket 78-72 on the consumer. It seems incredulous that a study of the impact was not made, since the data could be made available. Instead, we are making a great leap into the unknown with no clear idea as to its consequences.

I cannot demonstrate the impact of the access charge plan on all rural companies, but I can estimate the impact on the consumer in our company's operating territory.

Peninsula's toll settlements revenues are 39% interstate and 61% intrastate. Based on our last closed cost study, which was December 31, 1981, our total toll revenue requirement was $2,389,273.[1] Of that total, A Revenue was $1,973,675, or 83%; B Revenue was $103,695, or 4%; and Line Haul was $311,903, or 13%

The settlements shift at the end of the transition period under the 78-72 access charge environment reduces our A Revenue to $391,421, c 16%, shifting $1,582,254, or 66%, to local.[2] That 66% revenue shift must be made up by our customers through access charges minus whatever contribution is forthcoming from the Universal Service Fund.

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[1] See Attachment A, "Current Settlement Procedures".

[2] See Attachment B, "Settlements Under 78-72 Concept".

On the average, our customers could realize an estimated $34.00/month increase in local network access line rates. Keep in mind this doesn't give effect to inflation over the seven-year transition period nor does it include the impact of detariffing of station apparatus, the expensing of station connections or depreciation changes.

The impact of including the effect of detariffing station apparatus, expensing station connections and depreciation changes our settlements revenue to 3% A, 4% B, 13% Line Haul, and a revenue shift to local of 79%.[3] The combined effect is an average increase of $40.85 per access line or an average local access line rate of close to $54.00 per month.

Needless to say, the combined effect of the FCC rulings could have a horrendous impact on our customers. Other rural companies and their customers could be affected similarly but in varying degrees depending on their individual situation.

Question #3: Does the access charge plan in Docket 78-72 adequately protect the Universal Service concept for rural America?

From my rural viewpoint, the answer has to be no. The FCC, in paragraph $161 of its unpublished Third Report and Order in Docket 78-72, says, "We are totally committed to insure that this approach does not lead to a disruption of our nation's telecommunications system or to the elimination of universal service."[4] In a footnote to paragraph 161 the FCC comments, "The term 'universal service' while not appearing in the Communications Act is, in our opinion, an important mandate of that Act. It does not, however, mean that every household, without exception, need have a telephone." They further comment in the footnote, "We believe that the concept of universal service in the context of common carrier telecommunications means that high quality telephone service be available at rates which do not make such basic service a luxury."

I would contend that an average $54.00 per month rate for basic service moves that service very close to luxury for many American wage earners. I would also contend that at that rate, universal service is seriously threatened.

Currently, an estimated 98% of all households have basic telephone service. Is 98% universal service or is 90% or 85%? If we were to assume the current 98% met the universal service goal, what might be the decrease in telephone demand ude to Docket 78-72 if applied to both inter and intrastate?

Dr. Lewis J. Perl, currently Senior Vice President of National Economic Research Association, estimated in a study made in 1978 that an increase of 10% in local exchange rates could cause 3% of rural residential customers to drop off the network.[5] An AT&T study submitted as an exhibit in Docket 80-286 indicated that a 200% increase in basic telephone rates could cause a reduction of 24.56% in rural households accepting basic exchange service.[6] The AT&T study indicated when considering the moderately poor rural demographic group, over 32.9% would discontinue service when faced with a 200% rate increase. Will universal service survive with a 10% or 20% or 30% reduction in households accepting exchange service? Do the FCC, State Commissions or Congress know? I doubt it. How are we going to find out? By experience?

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[3] See Attachment C, "Settlements Under 78-72, 231/232 Deregulation and Depreciation Changes".

[4] See Federal Communications Commission Docket No. 78-72, Phase I, Section II, Paragraph 161.

I believe the evidence is strong that high access charges in rural areas will impair the goal of universal service. If access charges aren't pooled on a nationwide basis, universal service may not survive.

Question #4: Are there alternatives for State Regulators to lessen the Impact of Docket 78-72 on high cost exchange areas?

Given the access charge environment, I do not envy the job of State Regulatory Commissions, particularly if the Universal Service Fund in its final configuration does not meet the needs of the residential and small business consumer. In Washington State, 62% of all toll revenues for rural telephone companies are intrastate, leaving the bulk of the revenue sHift dilemma in the hands of State Regulators. What course of action is available to State Regulators to solve the dilemma the FCC has handed them? So far, I have heard of no effective panacea; however, several have been suggested.

One alternative suggested is statewide averaging of local access line rates. Statewide averaging would be of little utility to customers in high cost states, because no appreciable change would result.

A similar alternative mentioned is regional pooling. This concept also would appear to be of little utility to customers in high cost regions, such as the Western United States, for the same reason that state pooling wouldn't help.

It appears that without borad averaging, unreasonable access charges are inevitable.

Regardless of what happens at the federal level, rural companies and State Regulators need to become actively involved in the formation of intrastate Exchange Carrier Associations within their respective states for development and implementation of intrastate access charge plans. They need to give full attention and priority in developing an intrastate access charge plan that includes an adequate high cost factor as part of an intrastate universal service fund which will insure intrastate access charges do not place as severe a burden on the rural telephone consumer as the interstate access charge plan appears to do. The proper formation and administration of a state Exchange Users Association could be pivotal to the survival of universal service for rural consumers.

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[5] See L. Perl, Economic and Demographic Determinants of Residential Demand for Basic Telephone Service, 1978.

[6] See Attachment D, "Demand Elasticity Material from an Antitrust Case Exhibit", which was filed by AT&T in FCC Docket 80-286.

The "alternative of last resort" is for Congress or State Legislators to discharge their responsibility and define universal service. Furthermore, they need to define who is the public and what is in the public interest. Is the public only AT&T, large interexchange carriers and the Fortune 500, or does the public also include residential and small business telephone consumers? If the public interest is to be served, these definitions need to be made in the form of national policy and backed by public law through Congressional action. In the absence of federal policy, states may have to fill the policy vacuum.

In conclusion, I would offer one observation I believe the FCC, Congress, State Regulators, and State Legislators need to keep in mind as the transition period for Docket 78-72 begins in 1984. The primary reason we have a regulated telecommunications system today is due to the original failure of the marketplace to serve the telecommunications needs of the public. Let's not destroy universal service by blind concern for economic efficiency while ignoring the adverse social impacts and practical effect on residential and small business concerns. There is still time to fine tune the access charge plan and jurisdictional separations process to salvage universal service.

Mr. Wyden. Mr. Michael Woody, director of telecommunications, department of general administration, State of Washington, Olympia, WA.

TESTIMONY OF MICHAEL WOODY, DIRECTOR OF TELECOMMUNICATIONS, DEPARTMENT OF GENERAL ADMINISTRATION, STATE OF WASHINGTON

Mr. Woody. Thank you, Mr. Chairman. I appreciate the opportunity to testify again today on the issue of bypass. My perspective is that of a telecommunications manager and not a policymaker within the State of Washington. This viewpoint is seen as one from within the State government of Washington.

In its use of telecommunications goods and services, the State government of Washington shares the concerns and objectives with the private business sector, and particularly small business operations where operating budgets are sensitive to sharply rising costs. These common concerns are that we both strive to procure and operate systems that are efficient and cost effective.

The State is not unique in how it tries to meet the business requirements of its using agencies. To date, most network services operate through the local exchange network and the local utility companies. There are some unique requirements, however, which are best provided through what is referred to as bypass techniques.

The department of emergency services needs a network or facility in place that can be relied upon to function in cases of natural disasters. For example, when Mount St. Helens erupted in 1980, the public was advised to not use the public telephone system unless it was absolutely necessary. Yet everybody did, and the network bogged down, preventing critical, lifesaving communication. During this disaster Cowlitz County was responsible for coordinating the rescue and public safety operations.

A command center was set up at the small airport in Toledo, WA. Communications with the outside world was an immediate crisis because the small independent operating telephone company, Toledo Telephone, only had around 1,300 lines in its entire network and did not have adequate facilities to serve the disaster command center established at the airport. To solve the problem, the Air Force search and rescue unit brought in a Jeep equipped with a satellite dish.

Communications were established to other public safety and service agencies within the State of Washington by beaming the call up to the Westar III satellite and down to a General Electric experimental laboratory located in Connecticut. The laboratory, using a patching arrangement, connected the calling party at the Toledo Airport to the local exchange company located in New England which then placed the long-distance call back across country into the State of Washington to the desired agency.

This is an example where bypass technology was used because the local exchange network was neither designed nor capable of meeting the demand of the user in the timeframe required.

The department of natural resources has a system that connects the agency's headquarters in Olympia, WA, to its mobile fire patrol vehicles and helicopters. It owns its own private microwave system that serves this function. It has towers remotely located throughout the State in order to accomplish this. In addition to serving its own needs, the department also provides mobile dispatching service to the U.S. Forest Service, the parks and recreation commission, the department of ecology, and the department of revenue.

The department of natural resources installed its own bypass system because typically local exchange telephone companies do not provide services in the remote areas of the forest where the need for the department is critical.

The department of transportation has a private microwave system that is used for mobile radio dispatching of highway maintenance and repair vehicles. Additionally, the network supports circuits that provide remote control of highway weigh station signs and mountain pass weather alert signs.

The department of transportation installed its own system because the local exchange companies are not in the business of providing statewide paging service. The department needed a system that would fulfill its unique requirements.

The Washington State patrol has a private microwave network that is used for public safety and law enforcement purposes. It supports a statewide mobile radio dispatching system. It has rather stringent security requirements due to the sensitivity of the information that it carries.

The State patrol installed its own system because of the security requirements and the essential need for a statewide mobile dispatching system—a service not offered by the local exchange companies.

Mr. Chairman, your recent communication on the bypass issue asked the question "Do you think 'bypass' threatens the financial well being of the regulated telephone companies?" My answer is that in all of the instances of bypass that are currently used by the State government of Washington, there is no revenue loss to any local exchange company.

The companies either are not in the business of providing the service required or it could not have been provided in sufficient capacity in a timely manner. As to whether or not these systems threaten the financial well-being of the regulated telephone companies, my observation is that these systems have all been in place for years with no observable signs of financial plight mainly because these systems do not represent any loss of business or revenue to the local exchange companies.

Mr. Chairman, I thank you for the opportunity to share with you some of the facts about bypass within the State government of Washington and I would be willing to answer any questions you may have.

Mr. WYDEN. Thank you.

[Mr. Woody's prepared statement follows:]

PREPARED STATEMENT OF MICHAEL D. WOODY, DIRECTOR OF TELECOMMUNICATIONS, DEPARTMENT OF GENERAL ADMINISTRATION, STATE OF WASHINGTON

MR. CHAIRMAN AND MEMBERS OF THE SPECIAL TASK FORCE ON TELEPHONES, MY NAME IS MICHAEL D. WOODY. I AM DIRECTOR OF TELECOMMUNICATIONS FOR THE DEPARTMENT OF GENERAL ADMINISTRATION OF THE STATE OF WASHINGTON. I APPRECIATE THE OPPORTUNITY TO TESTIFY TODAY ON THE ISSUE OF BYPASS. MY PERSPECTIVE IS THAT OF A TELECOMMUNICATIONS MANAGER; THIS VIEWPOINT IS SEEN AS ONE FROM WITHIN THE STATE GOVERNMENT OF WASHINGTON.

IN ITS USE OF TELECOMMUNICATIONS GOODS AND SERVICES, THE STATE GOVERNMENT OF WASHINGTON SHARES THE CONCERNS AND OBJECTIVES WITH THE PRIVATE BUSINESS SECTOR, AND PARTICULARLY, SMALL BUSINESS OPERATIONS WHERE OPERATING BUDGETS ARE SENSITIVE TO SHARPLY RISING COSTS. THESE COMMON CONCERNS ARE THAT WE BOTH STRIVE TO PROCURE AND OPERATE SYSTEMS THAT ARE EFFICIENT AND COST EFFECTIVE. THE STATE IS NOT UNIQUE IN HOW IT TRIES TO MEET THE BUSINESS REQUIREMENTS OF ITS USING AGENCIES. TO DATE, MOST NETWORK SERVICES OPERATE THROUGH THE LOCAL EXCHANGE NETWORK AND THE LOCAL UTILITY COMPANIES. THERE ARE SOME UNIQUE REQUIREMENTS, HOWEVER, WHICH ARE BEST PROVIDED THROUGH WHAT IS REFERRED TO AS BYPASS TECHNIQUES.

THE DEPARTMENT OF EMERGENCY SERVICES NEEDS A NETWORK OR FACILITY IN PLACE THAT CAN BE RELIED UPON TO FUNCTION IN CASES OF NATURAL DISASTERS. FOR EXAMPLE, WHEN MT. ST. HELENS ERUPTED IN 1980, THE PUBLIC

WAS ADVISED TO NOT USE THE PUBLIC TELEPHONE SYSTEM UNLESS IT WAS ABSOLUTELY NECESSARY. YET EVERYBODY DID, AND THE NETWORK BOGGED DOWN, PREVENTING CRITICAL, LIFE SAVING COMMUNICATION. DURING THIS DISASTER COWLITZ COUNTY WAS RESPONSIBLE FOR COORDINATING THE RESCUE AND PUBLIC SAFETY OPERATIONS. A COMMAND CENTER WAS SET UP AT THE SMALL AIRPORT IN TOLEDO, WASHINGTON. COMMUNICATIONS WITH THE OUTSIDE WORLD WAS AN IMMEDIATE CRISIS BECAUSE THE SMALL INDEPENDENT OPERATING TELEPHONE COMPANY, TOLEDO TELEPHONE, ONLY HAD AROUND 1300 LINES IN ITS ENTIRE NETWORK AND DID NOT HAVE ADEQUATE FACILITIES TO SERVE THE DISASTER COMMAND CENTER ESTABLISHED AT THE AIRPORT. TO SOLVE THE PROBLEM THE AIR FORCE SEARCH AND RESCUE UNIT BROUGHT IN A JEEP EQUIPPED WITH A SATELLITE DISH. COMMUNICATIONS WERE ESTABLISHED TO OTHER PUBLIC SAFETY AND SERVICE AGENCIES WITHIN THE STATE OF WASHINGTON BY BEAMING THE CALL UP TO THE WESTAR III SATELLITE AND DOWN TO A GENERAL ELECTRIC EXPERIMENTAL LABORATORY LOCATED IN CONNECTICUT. THE LABORATORY, USING A PATCHING ARRANGEMENT, CONNECTED THE CALLING PARTY AT THE TOLEDO AIRPORT TO THE LOCAL EXCHANGE COMPANY LOCATED IN IN NEW ENGLAND WHICH THEN PLACED THE LONG DISTANCE CALL BACK ACROSS COUNTRY INTO THE STATE OF WASHINGTON.

THIS IS AN EXAMPLE WHERE BYPASS TECHNOLOGY WAS USED BECAUSE THE LOCAL EXHCHANGE NETWORK WAS NEITHER DESIGNED NOR CAPABLE OF MEETING THE DEMAND OF THE USER IN THE TIMEFRAME REQUIRED.

THE DEPARTMENT OF NATURAL RESOURCES HAS A SYSTEM THAT CONNECTS THE AGENCY'S HEADQUARTERS IN OLYMPIA, WASHINGTON, TO ITS MOBILE FIRE PATROL VEHICLES AND HELICOPTERS. IT OWNS ITS OWN PRIVATE MICROWAVE SYSTEM THAT SERVES THIS FUNCTION. IT HAS TOWERS REMOTELY LOCATED

THROUGHOUT THE STATE IN ORDER TO ACCOMPLISH THIS. IN ADDITION TO SERVING ITS OWN NEEDS, THE DEPARTMENT ALSO PROVIDES MOBILE DISPATCHING SERVICE TO THE U.S. FOREST SERVICE, THE PARKS AND RECREATION COMMISSION, THE DEPARTMENT OF ECOLOGY, AND THE DEPARTMENT OF REVENUE.

THE DEPARTMENT OF NATURAL RESOURCES INSTALLED ITS OWN BYPASS SYSTEM BECAUSE TYPICALLY LOCAL EXCHANGE TELEPHONE COMPANIES DO NOT PROVIDE SERVICES IN THE REMOTE AREAS OF THE FORESTS WHERE THE THE NEED FOR THE DEPARTMENT IS CRITICAL.

THE DEPARTMENT OF TRANSPORTATION HAS A PRIVATE MICROWAVE SYSTEM THAT IS USED FOR MOBILE RADIO DISPATCHING OF HIGHWAY MAINTENANCE AND REPAIR VEHICLES. ADDITIONALLY, THE NETWORK SUPPORTS CIRCUITS THAT PROVIDE REMOTE CONTROL OF HIGHWAY WEIGH STATION SIGNS AND MOUTAIN PASS WEATHER ALERT SIGNS.

THE DEPARTMENT OF TRANSPORTATION INSTALLED ITS OWN SYSTEM BECAUSE THE LOCAL EXCHANGE COMPANIES ARE NOT IN THE BUSINESS OF PROVIDING STATEWIDE PAGING SERVICE. THE DEPARTMENT NEEDED A SYSTEM THAT WOULD FULFILL ITS UNIQUE REQUIREMENTS.

THE WASHINGTON STATE PATROL HAS A PRIVATE MICROWAVE NETWORK THAT IS USED FOR PUBLIC SAFETY AND LAW ENFORCEMENT PURPOSES. IT SUPPORTS A STATEWIDE MOBILE RADIO DISPATCHING SYSTEM. IT HAS RATHER STRINGENT SECURITY REQUIREMENTS DUE TO THE SENSITIVITY OF THE INFORMATION THAT IT CARRIES.

THE STATE PATROL INSTALLED ITS OWN SYSTEM BECAUSE OF THE SECURITY REQUIREMENTS AND THE ESSENTIAL NEED FOR A STATEWIDE MOBILE DISPATCHING SYSTEM - A SERVICE NOT OFFERED BY THE LOCAL EXCHANGE COMPANIES.

MR. CHAIRMAN, YOUR RECENT COMMUNICATION ON THE BYPASS ISSUE ASKED THE QUESTION "DO YOU THINK 'BYPASS' THREATENS THE FINANCIAL WELL BEING OF THE REGULATED TELEPHONE COMPANIES?" MY ANSWER IS THAT IN ALL OF THE INSTANCES OF BYPASS THAT ARE CURRENTLY USED BY THE STATE GOVERNMENT OF WASHINGTON, THERE IS NO REVENUE LOSS TO ANY LOCAL EXCHANGE COMPANY. THE COMPANIES EITHER ARE NOT IN THE BUSINESS OF PROVIDING THE SERVICE REQUIRED OR IT COULD NOT HAVE BEEN PROVIDED IN SUFFICIENT CAPACITY IN A TIMELY MANNER. WHETHER OR NOT THESE SYSTEMS THREATEN THE FINANCIAL WELL BEING OF THE REGULATED TELEPHONE COMPANIES: MY OBSERVATION IS THAT THESE SYSTEMS HAVE ALL BEEN IN PLACE FOR YEARS WITH NO OBSERVABLE SIGNS OF FINANCIAL PLIGHT MAINLY BECAUSE THESE SYSTEMS DO NOT REPRESENT ANY LOSS OF BUSINESS OR REVENUE TO THE LOCAL EXCHANGE COMPANIES.

MR. CHAIRMAN, I THANK YOU FOR THE OPPORTUNITY TO SHARE WITH YOU SOME OF THE FACTS ABOUT BYPASS WITHIN THE STATE GOVERNMENT OF WASHINGTON AND I WOULD BE WILLING TO ANSWER ANY QUESTIONS YOU MAY HAVE.

Mr. Wyden. Mr. Conkling.

TESTIMONY OF GARY L. CONKLING, MANAGER, GOVERNMENT RELATIONS, TEKTRONIX, INC.

Mr. Conkling. Thank you, Mr. Chairman and Mr. Skelton, for this opportunity to provide some information about my company's views on alternative telecommunication carriers and techniques. I am Gary Conkling, manager of telecommunications for Tektronix, which is a large electronics instrument, computer graphics, and television equipment manufacturer with most of its primary operations in Oregon and southwest Washington. With annual sales of $1.3 billion, Tektronix spends more than $130 million on research and development to remain competitive in an increasingly challenging worldwide electronics marketplace.

We employ more than 20,000 people worldwide, with one-quarter of them being engineers involved in technology development, product design, and manufacturing efficiency.

As a major manufacturer of computer-aided design tools for engineers, Tektronix in the mid-1970's embarked on a strategic plan of distributing key corporate data bases and computer-resident design tools among our principal sites. The goal: To move data between many sources as rapidly and as accurately as possible.

We believed then—and we are positive now—that this was a key step in maintaining our competitive edge.

At the time we made this decision, the common carrier that served our primary operating sites had insufficient offerings to accommodate our rigorous needs and anticipated growth rates. Our technical people who dealt with the common carrier felt it was not interested in developing this capability.

That left Tektronix with little else to do but to build its own telecommunication system. It was not a decision we relished, and certainly not a decision without its own anguish.

For our purposes, Tektronix selected a digital microwave system. This system employs a relatively advanced technology which is substantially more expensive than other techniques for voice service exclusively.

This system remains in use today. It has been a success and has met its strategic purpose. It also has branded Tektronix as a telephone bypasser, even though it was not installed to avoid common carrier service for voice transmission. We are a bypasser because we would have been economic fools not to piggyback intersite voice transmissions on our microwave.

Today Tektronix employs several techniques to accommodate intersite data and voice communications requirements:

The Tektronix-owned digital microwave system supporting data and voice transfer among Tektronix's four largest manufacturing sites, which I have just described;

A number of intersite voice and data trunks leased from telephone companies;

Coaxial broadband intersite data services leased from a cable television company; and

Coaxial broadband intersite data services leased from a telephone company.

In the post-AT&T breakup era, telephone companies are beginning to install higher speed data lines and fiber optics in the Portland service area. Lead times for new service is often quoted as more than 6 months, but despite the delays, Tektronix has acted on a half dozen opportunities in the last year to contract for high-speed data service from telephone companies using alternative technologies to common voice transfer technology. It also is true Tektronix in other instances has chosen a nontelephone vendor for similar service.

I would like to emphasize that in the course of several upgrades to our own intersite telecommunications system in the past 2 years, we have chosen consistently to lease service from telephone companies or from a competing vendor rather than to invest further in our own system.

This reflects our long-standing interest in avoiding being in the telecommunications business. And, in our view, it also underscores the value of increased competition in telecommunications services, especially in the local service marketplace and in the field of data transmission where there are several emerging technologies that need to be tested.

Competition, as it does almost everywhere, pushes development-oriented research and reduces costs. One medium speed data link from our Clark County, WA, site to our main Beaverton campus is leased for more than $2,000 per month. This link, incidentally, carries only a fraction of the total intersite data traffic volume between these two sites. Recent competition between telephone companies and alternative vendors has already led to dramatically lower price quotations and vastly improved technological choices.

With this background in mind, let me summarize our views on the bypass issue:

We regard bypass charges, at least in our circumstance, as little more than taxes. They are a thinly veiled form of cross-subsidy that is based, in many cases, on ideology, not fact. They would appear to be aimed at discouraging competition, not encouraging it. I certainly would agree with Congressman Swift's earlier remarks that oftentimes bypass is used as a bugaboo.

Many bypassers, including Tektronix, do so not for direct economic benefits, but for competitive reasons. When we built our own system, we had virtually no choice. Moreover, it was extremely costly to Tektronix, while—from a capital outlay point of view—it didn't cost ratepayers a cent.

Bypassing the common carrier system, while a threat to universal service, is also a signal that regulated tariffs do not reflect actual costs of service to many classes of customers. The greater threat to universal service—and to a functioning telecommunications system—is a pricing system that forces one user group to pay another user group's bill.

Despite some of the extravagant charges, bypasses aren't skipping out on the entire common carrier system. For example, Tektronix pays more than $350,000 per month to telephone companies just for local service. That bill, by the way, is higher than what we paid before we built our microwave system.

Government policy, in our opinion, should be forward-looking regarding telecommunications. There will be greater and greater demand for data transmission by industry, business, and individuals and a system must be developed that meets their needs. The best way to meet those needs in our opinion is through procompetitive policies and through telecommunication alternatives.

Telecommunication alternatives are in their infancy and should be encouraged, not discouraged through pricing disincentives that result from overregulation or overprotection of certain customer markets.

Well-managed, aggressive telephone companies can survive in a competitive atmosphere and, indeed, flourish. They will need to operate differently than they did when they were regulated. But in competing from dawn to night for business they will be in good company.

Thank you very much for the opportunity.

[Mr. Conkling's prepared statement follows:]

PREPARED STATEMENT OF GARY L. CONKLING, MANAGER, GOVERNMENT RELATIONS, TEKTRONIX, INC.

Thank you, Mr. Chairman and members of the Task Force, for this opportunity to provide some information about my company's views on alternative telecommunication carriers and techniques.

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Tektronix employs more than 20,000 people worldwide, with one-quarter of them being engineers involved in technology development, product design and manufacturing efficiency.

As a major manufacturer of computer-aided design tools for engineers, Tektronix in the mid 1970s embarked on a strategic plan of distributing key corporate data bases and computer-resident design tools among our principal sites. The goal: To move data between many sources as rapidly and as accurately as possible.

We believed then -- and we are sure now -- that this was a key step in maintaining our competitive edge.

At the time we made this decision, the common carrier that served our primary operating sites had insufficient offerings to accommodate our rigorous needs and anticipated growth rates. Our technical people who dealt with the common carrier felt it was not interested in developing this capability.

That left Tektronix with little else to do but to build its own telecommunication system. It was not a decision we relished, and certainly not a decision without its own anguish.

For our purposes, Tektronix selected a digital microwave system. This system employs a relatively advanced technology which is substantially more expensive than other techniques for voice service exclusively.

This system remains in use today. It has been a success and has met its strategic purpose. It also has branded Tektronix as a telephone bypasser, even though it was not installed to avoid common carrier service for voice transmission. We are a bypasser because we would have been economic fools not to piggyback intersite voice transmissions on the microwave.

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In the post-ATT breakup era, telephone companies are beginning to install higher speed data lines and fiber optics in the Portland service area. Lead times for new service is often quoted as more than six months. Despite the delays, Tektronix has acted on a half dozen opportunities in the last year to contract for high speed data service from telephone companies using alternative technologies to common voice transfer technology. It also is true, Tektronix in other instances has chosen a non-telephone vendor for similar service.

I would like to emphasize that in the course of several upgrades to Tektronix' own intersite telecommunications system in the past two years, we have chosen consistently to lease service from telephone companies or from a competing vendor rather than to invest further in our own system.

This reflects our longstanding interest in avoiding being in the telecommunications business. And, in our view, it also underscores the value of increased competition in telecommunications services, especially in the local service marketplace and in the field of data transmission where there are several emerging technologies that need to be tested.

Competition, as it does almost everywhere, pushes development-oriented research and reduces costs. One medium speed data link from our Clark County, Washington site to our main Beaverton campus is leased for more than $2,000 per month. This link, incidentally, carries only a fraction of the total intersite data traffic volume between these two sites. Recent competition between telephone companies and alternative vendors has already led to dramatically lower price quotations and vastly improved technological choices.

With this background in mind, let me summarize our views on the bypass issue:

o We regard bypass charges as little more than taxes. They are a thinly veiled form a cross-subsidy that is based, in many cases, on ideology, not fact. They would appear to be aimed at discouraging competition, not encouraging it.

o Many bypassers, including Tektronix, do so not for direct economic benefits, but for competitive reasons. When we built our own system, we had virtually no choice. Moreover, it was extremely costly to Tektronix, while -- from a capital outlay point of view -- it didn't cost ratepayers a cent.

o Bypassing the common carrier system, while a threat to universal service, is also a signal that regulated tariffs do not reflect actual costs of service to many classes of customers. The greater threat to universal service -- and to a functioning telecommunications system -- is a pricing system that forces one user group to pay another user group's bill.

o Despite some of the extravagant charges, bypassers aren't skipping out on the entire common carrier system. For example, Tektronix pays more than $350,000 per month to telephone companies just for local service. That bill, by the way, is higher than what we paid before we built our microwave system.

o Government policy should be forward-looking regarding telecommunications. There will be greater and greater demand for data transmission by industry, business and individuals and a system must be developed that meets their needs. The best way to meet those needs is through pro-competitive policies and through telecommunication alternatives.

o Telecommunication alternatives are in their infancy and should be encouraged, not discouraged through pricing disincentives that result from over-regulation or over-protection of certain customer markets. In this context, bypassers are helping, not hurting, other telecommunication ratepayers by pushing technologies and creating new competitive influences that drive down costs.

o Well-managed, aggressive telephone companies can survive in a competitive atmosphere and, indeed, flourish. They will need to operate differently than they did when they were regulated. But in competing from dawn to night for business they will be in good company.

One final point. Tektronix believes that business should act as responsible contributors to our social fabric. We also believe universal telephone service at an affordable price is an important and achievable goal.

It is our belief that competition will play a large part in achieving that goal and that unnecessary and unfair cross-subsidies will stifle the competition we must have.

Mr. **Wyden**. Just a few questions. We will start with you, Mr. Woody. We have thrashed already for 4½ hours here on this bypass question. You are on the front lines, you see this all the time, and it is your conclusion that bypass hasn't cost any local phone company revenue; is that essentially your point?

Mr. **Woody**. In the instances that are being used by the State of Washington.

Mr. **Wyden**. I see also you are aware of some other instances of companies either not in the business of providing the services required or it could not have been provided in sufficient capacity in a timely manner. Are you familiar with instances outside the government as well? At least that is the way I read that sentence. It is on your last page.

Mr. **Woody**. I am referring specifically to the State of Washington and that is all, the State government of Washington.

Mr. **Wyden**. So that private companies are something else?

Mr. **Woody**. It would be the local utility companies.

Mr. **Wyden**. If you could elaborate a little bit on that last point either now or in writing in the future, I think that this—we are entering the great bypass debate, how serious is it, what should we do about it. We need to hear from people like yourself on the front lines.

Mr. **Woody**. I guess what I am suggesting is that a generic policy that deals with bypass as a single issue with complete disregard for the reasons a user would bypass would certainly not be in the best interest of the ratepayer. Because, as I indicated in my testimony, there are instances of bypass where the service cannot be obtained from any other source other than providing it yourself, and that is not the same issue where a user would install a system which would result in stranded investment for the company. A policy not recognizing that I don't believe would be in the best interest.

Mr. **Wyden**. Do you foresee a time in the future when bypass will be a great threat?

Mr. **Woody**. I feel that local service is the last vestige of monopoly within the telephone industry and that eventually, as technology advances and as we have seen the cost of calculators and the cost of PC's come down, the cost of bypass technology will come down. And as it comes down it will be more available to a larger sector of the business community and you will in fact see more bypassing being implemented as that price does come down. As that happens, you will see more and more competition coming into the local exchange marketplace.

Mr. **Wyden**. Mr. Conkling, your experience with bypass, you didn't do it for price reasons. Because you are so active in the high-technology field, president of the Beaverton Chamber of Commerce, what do you see happening in this area? We often assume that it is easy to bypass and you ought to do it when you feel like it. There is enormous investment and risk in doing it. Your feelings on what is ahead on this bypass issue as well would be helpful.

Mr. **Conkling**. I agree with much of what Mr. Woody indicated. We have tried to differentiate between voice and data transmission, which is, I think, a helpful distinction to look at. It is one measure with which to look at the intentions and the purposes for what today are viewed as bypass.

In our case our motivation was not cost. What we did was much more costly. We undertook our system for reasons of need that really fit a strategic pattern for our own corporate well-being. The term that I used—and maybe I should have made a greater point of it—is that today what we call bypass tomorrow may be an alternative that becomes a preferred alternative. In the local service area we ought not to do any customer the disservice of imagining that we have a rigid technology environment. We have a situation with competing technologies offered by telephone companies, and other companies, that offer a variety of alternatives that meet several needs. One of our concerns is that, in whipping up strong feelings about bypassing, we often forget that one of the things that we are doing is providing a testing ground for some of these alternatives today.

We are not asking anyone to subsidize that. Our example indicates the contrary, we are subsidizing it. And, it is a valid technology to see how it is working.

Mr. Wyden. I don't think anybody in Congress is talking about barring bypass or anything of the sort. The question is how it should be handled and particularly how we shape those new technologies.

A question for you, Mr. Ericson. You talk about the pollution of information, and there are things you think that this task force could do to help you, as a manager of a small company, to reduce the pollution of information. I think you would find receptive ears.

Mr. Ericson. Given the access charge environment and the changes being made, I don't see how you could help us other than to turn back the clock and reverse the access charge decision. Regarding bypass, our company has had bypass for years, and we view the biggest threat of bypass, at least in the past, from government. We have had four instances in our own exchange territory that impact our gross revenues to the tune of probably a quarter of a million dollars.

We have had the U.S. Coast Guard parallel our system and the State SCAN network is a form of bypass. The U.S. Navy has constructed a microwave system paralleling our microwave system, as has the U.S. Coast Guard, to one of our exchanges. If we are talking economic efficiency, I question whether this type of bypass really is economic. If government agencies are to receive funding for capital projects without having to prove the economic efficiency of it, then they will go out and build these systems. We have had it happen to us, so it is nothing new.

Mr. Wyden. Mr. Woody is shaking his head.

Mr. Ericson. I didn't expect him to agree.

Mr. Woody. The State SCAN network has been characterized in the past as a bypass network, and I have gone on record that it is not a bypass network. It uses the local exchange company in every instance.

Mr. Wyden. One last question for you, Ken, and then I will turn it over to Mr. Skelton. You put up that diagram and you had what struck me as an interesting compromise idea. You basically suggest that we just divide up the nontraffic-sensitive costs and everybody takes a chunk of them; is that right?

Mr. **Sandner**. That is what our proposal is, and of course the proposal does include, over and above that, a universal service fund to help keep rates down in the higher cost areas like Condon, for example.

Mr. **Wyden**. I would like to see that, because I suspect that is where we are going to find the debating ground move to early on. How do you allocate? If you all have a proposal on board already, that would be very helpful to see.

Mr. **Sandner**. We will try to get you the complete details.

Mr. **Wyden**. Very good.

Mr. Skelton?

Mr. **Skelton**. I think you have covered everything and in view of the fact that we have run out of time, I have no questions. Thank you very much.

Mr. **Wyden**. Let me thank you, our last panel and our other participants. I think this has been an extremely helpful hearing. I think it shows the breadth of concern on the issue. It also shows we have some dramatic differences of opinion on how to deal with the matter, although I think it is pretty obvious that the people of the Northwest all want to get to the same goal, which is affordable universal service. If we roll up our sleeves, we have got between now and the next Congress, between now and the time of the next State legislature meetings to go after it together and look at the options. This has been helpful in moving us toward that goal. With that, the task force adjourns for the day.

[Whereupon, at 1 p.m., the task force adjourned, to reconvene subject to call of the Chair.]

IMPACT OF CHANGES IN THE TELECOMMUNICATIONS INDUSTRY ON SMALL BUSINESS

(Part 2)

FRIDAY, AUGUST 24, 1984

House of Representatives,
Special Task Force on the Impact of Telephone Costs,
Committee on Small Business,
Kansas City, MO.

The task force met, pursuant to notice, at 10 a.m., in room 140, Federal Building, 601 East 12th Street, Kansas City, MO, Hon. Ron Wyden (chairman of the task force) presiding.

OPENING STATEMENT OF CHAIRMAN WYDEN

Mr. Wyden. Good morning.

Today the House Small Business Committee task force on telephones has come to Kansas City at the request of a good friend and colleague, Ike Skelton, to hear the concerns of midwestern residents about telephone rates and telephone services.

The committee has already held a hearing in Washington, DC. Yesterday we were in Seattle and shared the concerns of residents in my home region, the Pacific Northwest. The task force will be holding other hearings as well. Then we plan to issue recommendations to the full House Small Business Committee by November 30 on how to best hold down telephone rates in this country for small business.

Now by way of just a short introductory statement. I am of the view that telephone rates and communications issues are going to be the pocketbook consumer concern in the 1980's. Whether the ratepayer is at the office or at home, the communications world has undergone a radical transformation in recent months—not all the implications of this transformation are necessarily good ones—and you see the changed world so many ways on an ongoing basis.

Last weekend I was at a dedication in my congressional district in Portland. I think almost all of us are familiar with congressional dedications. It is almost always a Member of Congress dedicating a dam, or a bridge, or a highway. It is a happy occasion when they are cutting a ribbon or something of that nature. Well, last weekend I was at something of a different dedication in my district. What we were doing, we were dedicating a community phone. This was a special phone that had been set up by a church in my district for parishioners and those in the neighborhood who could no longer afford telephone service. It was going to be staffed by church volunteers and those in the community to take messages from friends and relatives and doctors and messages of an emergency nature.

I remember saying that I had somewhat ambivalent feelings about being at this dedication. On the one hand, it was great because the community had risen to the occasion and had helped people in need; and, on the other hand, it was a little bit sad because, after 50 years of building our commitment to universal service to the point where something like 95 percent of the people in this country had a telephone, we were now faced with the prospect of needing community phones.

Surely all of us here today can agree that we want to keep our commitment to universal service and not create a climate where community phones are needed all through this country.

The fact is that none of us want an information aristocracy—if we are not careful in this area, that is what we might have—where those who are well to do have access to the fiberoptics and the robotics and all the fruits of the technological revolution, and those of modest means, be they business or consumer, are going to have difficulty getting access to a small black telephone.

So in the next Congress we will have to cope with the new communications world; and early next year one of our top priorities is going to be a rewrite of the Communications Act of 1934. Many of you know we have struggled with it for some time. One of the reasons we are seeking these recommendations about the concerns of small business is so that we can incorporate those concerns into a rewrite of the Communications Act of 1934.

I think we are also going to see early next year the State legislatures from coast to coast begin to turn to the subject in earnest as well, because with the Communications Act rewrite the State legislatures are going to have to respond in kind. So we have asked State officials and State legislators and those concerned on the State level to give their views as well. One last point. This is an extraordinarily complicated subject. I have come to feel that communications is a little bit like peeling an onion. You peel one layer and you get to another layer, and you peel the next layer and you get to another layer. There really are not any good guys or bad guys. It is an extraordinarily complicated issue. We are going to be looking at the options and all of their alternatives. That is why we are having this hearing.

Let me just say a word or two about my colleagues. I have two very, very admired and capable Members of Congress with me today. This hearing is at the request of the region's own Ike Skelton. You know, it is always kind of required to say nice things about somebody when you are in their hometown. That is congressional protocol. I always laugh and tell my colleagues do not ever come to my district because there is nothing nice I can say about you. But with Ike Skelton, you really cannot say enough good things about his commitment to small business, about ensuring that this country has universal service. He is one of the most admired Members of Congress. He is going to give an opening statement in just a moment.

Also, a word about a good friend and capable colleague, David Dreier. He is a hometown boy. He has migrated west and he now serves California in the Congress. Also, I like to think that, coming to Congress at the same time, we are part of the new breed. David will have some comments as well.

But with pleasure I now turn the microphone over to Ike.

Again, Ike, we thank you for taking the initiative to make sure that midwestern residents could have their concerns heard.

OPENING STATEMENT OF HON. IKE SKELTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. SKELTON. Ron, thank you so very much, and I welcome you to the State of Missouri and to the Midwest.

It is true, we had a very interesting hearing yesterday in Seattle, WA, and I welcome this task force, which, incidentally, is your brainchild. I think it is an excellent idea.

So you will understand, this task force is made up of members, bipartisan members, from the Small Business Committee. It is not a subcommittee as such. I am a subcommittee chairman dealing with exports, but people from all of the subcommittees were chosen for this particular task force. Congressman Wyden requested it and it was established. I am on it as a result of his invitation, and also a good friend, David Dreier, whom I, although he lives in California and represents California, like to call my constituent out here, a good friend and colleague. We are very proud that he represents his district very ably and very well in the U.S. Congress.

This is a telephone task force hearing.

Besides welcoming our friends—again, a special thanks to you, Congressman Wyden—I would like to point out that this is a very important undertaking for us. The hearing in Seattle yesterday underscored two things to me. No. 1, the great complexity that we have in the issues of the telephone problems; access charges being just one of them. The second problem that we have or the second issue that we have is the great difficulty in learning what it costs a telephone company to do business.

There were some estimates yesterday that came forth in the hearing as to what a certain service—the technical term is "hunting," and those of you in the telephone industry know what hunting is—what really is the cost of hunting. Hunting is, hooking up certain lines so you can complete a telephone call from one area to another, what is really the cost of that. The estimates range from 90 cents to $14.

Now, what is true, accurate and correct? This is going to be our job, to try to find some rational basis upon which to look at the costs. When we can do that, then, and only then, can we begin to make some recommendations.

The complexity of it is pretty much like having a jigsaw puzzle. You have the last piece of a jigsaw puzzle, you put it in and three pieces pop out. It is something that just does not mesh. So we will be asking a lot of questions, some of them just to learn the phraseology and how things work.

I am very concerned about what the FCC has done. This task force, in my opinion, is doing the homework that the FCC should have done before they issued their order singling out small businesses on the telephone access charges. I think they did it without very much, if any, attempt to learn the facts of what it is going to cost the small businessman in America.

The telecommunications industry is rapidly changing. After our hearing yesterday in Seattle, I went to the telephone, a toll call telephone, at the Seattle Airport, to call my Washington office, and I noticed I could choose not one, not two, but four manners of making the telephone call, AT&T, MCI, and two others, by punching a couple of numbers and hooking into that system and then calling my office in Washington. Months and years ago we would not have even thought of that. So the whole system has changed.

This task force was established to learn what these FCC access charges will do to small business. We are trying to find out what we can do, what we can recommend to the full committee in November. And that is our aim, to have a recommendation by November.

I am especially concerned about what this is going to do, not just to small businesses but to small businesses in rural America, small town America, the part of America that depends upon agriculture and agribusiness. Here in Kansas City, as we all know, it is very agriculturally and agribusiness oriented. What is it doing to us all across the Midwest? How do we maintain the affordable telephone system that we have enjoyed for all these years? What is a fair rate? Who gets a cut out of the prices that are unfair? Are certain parts of America going to be isolated because of telephone rates being too high and other parts being disproportionately low?

To all of these we are going to have to come up with some very difficult answers. We want to learn firsthand from the small business owners, the representatives of the telecommunications industry, and the public service commission.

We will be hearing from the public service commissioners. We will be hearing from small businesses.

The telecommunications industry really cannot be, in many aspects, linked together as one group because each of them has an adversarial role regarding the other members of the telecommunications industry. So it will be our task to sort out the problems of each of them.

Thank you again for coming to our hearing. We look forward to the testimony.

Again, thank you, Congressman Wyden, for being here, and our good friend Dave, we are glad to have you back home.

Mr. WYDEN. Ike, thank you for an excellent and thoughtful statement.

Dave, are there any comments that you would like to make?

OPENING STATEMENT OF HON. DAVID DREIER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. DREIER. Thank you very much, Mr. Chairman.

I would like to say at the outset that it is, in fact, with a great deal of pleasure that I am here.

I was elected to the 97th Congress with Ron Wyden. We are classmates in that respect. He has played a major leadership role on this issue. And Ike Skelton is one who has been a real leader in the Congress, one whom I have looked up to and have had the opportunity to spend a great deal of time with, and I appreciate the chance to be here with him.

This week some of my colleagues may think me a heretic to be sitting with two Democrats. After some of the speeches that you have heard over the last several days, one would think that there is not any bipartisan solidarity on any issue whatsoever, but I am very pleased to add a bipartisan flavor to this hearing. I am the only Republican here, maybe not in the room, but certainly on this panel. But I would like to say that it is very important for us to focus on this issue in a bipartisan way.

A major part of the platform that I was elected on was, and which the Republican platform endorsed was, deregulation. We know that deregulation has created many concerns on the part of many individuals. It has had on some industries a very beneficial impact and on other industries maybe a not so beneficial impact. I think that this task force which Chairman Wyden has assembled is in every way possible addressing this issue, and I laud him for that.

I believe that it is a very important aspect of understanding how our actions in Washington are seen around the country by holding these field hearings.

I feel adequately informed on how the telephone reorganization is causing problems for businesses in my own district.

And I have to say that I am very pleased and honored to have one of my constituents, a small businessman, here, Mr. Louis Brutocao from southern California. If you would stand, Louie. He is in the back of the room.

While many people believe that I was here solely to see Kansas City, I am pleased that there is a representative from my area who shares the same kind of concern.

There are over 14 million small businesses accounting for 98 percent of all business and almost 40 percent of our Nation's gross national product.

I would like to say that, in the economic recovery that began last year, two-thirds of all new jobs created and about 50 percent of all new business innovations were from the ranks of small business. Economists have taught for years that this is one of the most productive sectors of our economy. The President's recent state-of-the-small-business report to Congress for 1983 certainly verified this. That is why Congress is so very interested in this issue.

Those problems facing us today will eventually face the rest of the Nation as a whole and will directly affect the ability to perform, an ability on which the rest of the Nation is able to base its activity.

As we have learned from previous testimony in Washington, the changes in our national telephone system are just now getting underway. We can never return to the way it was organized during the preceding century of telephone operation. Progress and technology have moved this entire industry into the fast lane of change. Deregulation has allowed newer, smaller companies to specialize and develop more diverse services tailored to their specialty consumers.

The subsidies that AT&T was once able to provide some of their less profitable services are now gone and it is only natural that the price of these services will now go up until technology catches up with it.

Given this reality, it is up to Congress and the industry itself to make sure that no one segment of our Nation is unduly or unfairly hurt in the transition.

Access charges in particular were not extended to larger businesses which had the capability of developing their own communication systems because of the fear that they would pull out and leave much higher costs to those of us left. At the other end of the spectrum, families and single-line users were exempt from access charges. This leaves the burden squarely on the back of small businesses throughout the country, and that obviously is not fair.

The United States has the best communications system in the world, and I am confident that with the proper information we should be able to guarantee basic, inexpensive telephone service to all segments of American society.

As I mentioned earlier, it is very important for us to continue in this quest, and I laud both Chairman Wyden and Congressman Skelton for playing a leadership role in this.

I have to apologize. Another commitment that I have will force me to leave during one of the panels. I hope you, Mr. Chairman, will understand that the fact that I do have to leave in no way denigrates the impact and importance of this issue.

Mr. **Wyden**. Dave, thank you for an excellent statement, and particularly hammering at the bipartisan nature of the way in which we try to proceed on this task force and on the committee. There is nothing partisan about business growth. We have got to have it. It is a commitment of this task force. We thank you for a fine statement, Dave.

We are going to move ahead now with our first witness. It is Commissioner William Steinmeier, chairman, Missouri Public Service Commission, Jefferson City, MO.

Let me say that we are already starting to run a little bit behind. We would like to ask our witnesses to stay within about 5 minutes for their prepared comments.

Commissioner Steinmeier, we understand you were told you could have a little bit longer. As close as you can get to the 5, that would be great.

What we are going to do so that no one feels that their full statement will go unregarded, we will make your full statement a part of our record; it will be included automatically; then you can go right to highlighting your concerns in your own oral statement, and we will make the other a part of the record.

Commissioner Steinmeier, we are happy to have you here. If you have any staff or colleagues with you whom you would like to have join you, please come forward.

Could you, Commissioner, introduce all your people?

Mr. **Steinmeier**. Yes, Mr. Chairman, I would be pleased to do so. With me this morning are two of my colleagues from the Public Service Commission, Commissioner Charlotte Musgrave and Commissioner James N. Fischer; and also the executive director of our utilities division of our Public Service Commission staff, Mr. Gordon L. Persinger.

Mr. Persinger, I might add, is vice chairman of the Telecommunications Subcommittee of the National Association of Regulatory Utility Commissioners and is particularly well versed and experienced in the subjects being addressed by your task force today.

Mr. SKELTON. Pardon me.

For the record, Mr. Chairman, is it not correct that everyone's statement will be entered in the record in full and the reporter will have this, and then their comments or summary will be in addition thereto?

Mr. WYDEN. That is correct, it will be in addition thereto. In that way, your formal statement, right as you come up here, will go into the record.

Mr. STEINMEIER. Very well. Thank you.

TESTIMONY OF WILLIAM D. STEINMEIER, CHAIRMAN, MISSOURI PUBLIC SERVICE COMMISSION, ACCOMPANIED BY GORDON L. PERSINGER, CHARLOTTE MUSGRAVE, AND JAMES N. FISCHER

Mr. STEINMEIER. Chairman Wyden, Congressman Skelton, and Congressman Dreier, we are pleased and deeply appreciate the opportunity to testify before the task force this morning on these very important matters which you are addressing, matters of great public importance.

We had, as you have mentioned, earlier this week prefiled written testimony in this matter. I would attempt to highlight our concerns at this time.

The dramatic changes in the telecommunications industry and in the regulation of that industry in the last several years have resulted in increasing upward pressure on local exchange telephone rates and especially in smaller, rural exchanges.

The major concern of the Missouri Public Service Commission in the wake of these changes is a concern for the continued viability of universal telephone service. In that regard, it is our sincere concern that Federal action is way ahead of Federal planning.

There is a great deal of debate today over the effective access charges proposed by the FCC on local telephone customers, and this situation is aggravated by the fact that the access charge decision of the FCC occurred at a time when the telephone industry was experiencing unprecedented changes in other areas, including the deregulation of customer premises equipment, the mandate of the courts and the FCC to develop competition in the long-distance markets, and the changes which have resulted from the divestiture of the BOC's by AT&T.

The FCC has also enacted changes in depreciation practices and has made decisions to treat as current expenses costs that were previously capitalized. Of course we acknowledge that inflation and other factors have contributed to the increase in the cost of local exchange telephone service as well.

All of these activities in the industry are placing pressure on regulators to deaverage and restructure rates. While some may benefit from these changes, our major concern continues to be whether or not telephone service will be available to most customers at affordable rates. We believe that prices that are implemented at the Federal or State level should continue to meet the public interest standards of the Communications Act of 1934, which recognize that a primary objective for utilities is universal service at reasonable rates.

Pressure on the industry to deaverage and restructure rates also was heightened by changes in technology. The installation of digital switching and microwave and fiberoptics transmission facilities has greatly reduced the cost per circuit mile for many of the high volume routes. But local exchange service is being provided in much the same manner as it was 15 or 20 years ago. This means that the average customer is still receiving service over a pair of wires extending on a circuit from the local exchange company office to his business or residence location that is the local loop. This may be one of the reasons that the rate pressure in the new environment seems to be building on the local customer and basic telephone service rates.

Independent telephone companies have two basic sources of revenues, local service and toll service revenues. If the current trend toward deaveraging of rates continues, we can expect that both local exchange rates and toll rates for the small and rural companies will increase at a rather high rate because these areas generally have considerably higher costs per customer for the fixed facilities required to provide telephone service of any kind.

At the present time, Missouri has 48 telephone companies, of which 37 have less than 5,000 access lines. Even though Missouri has several major metropolitan areas, much of our territory is rural in nature, with low subscriber density and few large businesses or industries. At the present time, there does not appear to be a technology in the wings which will make a substantial downward difference in the cost of providing telephone service to customers in rural Missouri.

The divestiture, FCC action, and technological developments have caused a dramatic movement over the last several years toward reliance on competition wherever possible to control the telecommunications industry.

The concept of competition implies that rates will be deaveraged and firms have the freedom to enter and exit markets without regulatory oversight. The expected result of rate deaveraging and the free entry and exit of firms is that high-volume, low-cost routes should experience a decrease in rates, while low-volume, high-cost routes could see an increase in rates.

In the extreme, one must be concerned that if rates go too high one could observe telephone companies leaving the market and leaving communities without telephone service.

We have addressed other concerns in our written testimony, which I will not highlight this morning, including concern about the depreciation procedure changes of the FCC and their preemption of the States in that regard, and also our concerns about bypass, including some of the findings of the Missouri Commission in last year's *Southwestern Bell Telephone* case in which, in essence, the commission determined that it could not at this point in time, based on the evidence we have, establish a telephone rate structure which was designed to discourage bypass without being able to distinguish between uneconomic bypass, on the one hand, and economic or technological bypass, on the other, because to attempt to fashion such a rate structure could result merely in artificial raising of local exchange rates and pressure on small businesses and rural telephone companies and basic exchange customers throughout the State without, in fact, discouraging a whit of bypass.

Finally, let me mention that the major theme of the Missouri Public Service Commission filings before the FCC over the last year or two has been a plea to take the time to determine the estimated effect of the actions proposed to be taken prior to enacting something from which there is no turning back.

At the present time, we appear to be in a headlong rush toward the virtual deregulation of the telephone industry with little regard for the question of who will provide services to the remote areas of Missouri and other States where the costs of providing service may exceed the capability of the majority of the subscribers to pay. We believe it is mandatory that some long-term plans be made to insure the continuation of telephone service to all who desire it at affordable rates before we actually prove that competition does not work in all situations.

We appreciate your time this morning. We would be pleased to answer any questions you may have.

Mr. **Wyden**. Commissioner, thank you.

Would either of your two colleagues care to make a comment?

Ms. **Musgrave**. I believe the 5 minutes was stretched as it was. Thank you.

Mr. **Steinmeier**. We would be happy to answer questions.

Mr. **Wyden**. Good.

Congressman Skelton.

Mr. **Skelton**. Thank you, Mr. Commissioner. We appreciate your testimony.

It is interesting to note that you also feel, and you have stated it more plainly than we, that Federal action is ahead of the Federal planning. That is what we meant when we said we were doing the homework that the FCC should have done before they made their ruling dealing with the access charges.

Let me ask you—I am very, very concerned, Mr. Commissioner, about your comments on deaveraging—for the record, tell us, in layman's language, what deaveraging is.

Mr. **Persinger**. Traditionally, in a noncompetitive, purely monopoly telephone system, you have had a partnership approach to the collection and distribution of telephone revenues, costs, investment in plant, and as long as there was an end-to-end monopoly you could work out systems of sharing. You had a system whereby you took all of the costs of doing telephone business and you averaged those costs out so that a customer anywhere in the country calling from Rich Hill, MO, to New York City would pay basically the same rate as someone calling from Chicago, IL. The same distance of call would have the same cost regardless of the specific cost of providing that.

Mr. **Skelton**. Fine. Now, on deaveraging, that tilts it, does it not? Someone in Rich Hill, MO, out in rural Missouri, is going to be paying a higher price, proportionately a higher price, than someone between two major cities such as New York City and Chicago, is that correct?

Mr. STEINMEIER. Yes, sir.

Mr. SKELTON. What impact would this have on rural America, first the farmer and then the small town America?

Mr. STEINMEIER. We are concerned that as you move toward deaveraging and this simple phrase of costs paid by the cost causer. The costs of physical plant to provide telephone service in rural communities is much higher per customer than it is in densely populated metropolitan areas. I have cited an example of a recent small company case in northwestern Missouri in our written testimony where, in fact, the cost per customer, if I recall correctly, came out to something like $55 a month for the fixed costs to that customer outside of the base rate area of the local exchange. Now, it's a small company with a total of 650 customers. So the simple answer to your question is those customers are going to have much higher telephone bills than they have now and we cannot tell yet how high. They will be much higher than they are now, and $55 is an example; $55.43 per month was the figure as to that telephone company.

Mr. SKELTON. This disturbs me a great deal because, as you know, the farmers all throughout the Midwest, not just Missouri but all throughout the Midwest, for the past several years have had a very difficult time. Small towns in the Midwest and Missouri rely upon the agricultural economy being strong to prosper. And then on top of all of this, the farmer and his friends in the small towns have the potential of being hit with this large monthly telephone bill. That could be devastating to the economy of rural America. Do you agree with me on that?

Mr. STEINMEIER. We are very concerned about that, Congressman, yes, sir.

Mr. SKELTON. What is the answer, Mr. Commissioner? That is what we are here for.

Mr. STEINMEIER. I wish I knew that clearly and concisely. At the very least and in the immediate term, I would like to see the FCC slow down what I referred to a moment ago as this headlong rush. I think they have been rather ahead of themselves all along the way the last couple of years. Of course, they established an access charge plan and then some months later created a State-Federal joint board to look at access charges. They tried to design an access plan in part to prevent bypass, and then they undertook a comprehensive study of bypass; and I would hope that we would at least see them slowing down their movement toward change in the industry until they have more input from those of us who, I believe, are, in fact, closer to some of the real people who are going to have to pay those rural telephone bills and small business bills.

Mr. SKELTON. Mr. Chairman, I have numerous questions I would like to ask; but because we are limited on time, I will thank the Commissioner. And should we have additional questions that we would wish to submit to you, would you answer them for the record at a later moment?

Mr. STEINMEIER. We would be more than pleased to do so.

Mr. SKELTON. Thank you so much.

Mr. **Wyden**. Congressman Dreier.

Mr. **Dreier**. Commissioner, thank you very much. I enjoyed and appreciate your testimony.

What specific steps is your Commission taking now to protect basic minimum telephone service, first for individuals and then for small businesses?

Mr. **Steinmeier**. We have quite a number of telephone dockets going on at the moment of a rather generic or investigatory nature. As a result of changes in the industry, we are into a rather unique phase in our history at the moment where we do not have a lot of major rate increase cases pending before us, but we are looking into a number of specific problems that are arising out of some of these FCC actions.

We have an investigation going on into bypass. We are trying to establish a monitoring system for bypass in Missouri requiring quarterly reports from telephone companies as to what is happening on those fronts, so that we can try to have more specific information about bypass and its causes before we start adjusting local rates upward in order to meet that alleged threat, for example. We have in the short term controlled intralata competition in Missouri, and we have established two access charge pools in the last *Southwestern Bell* case which, because of the pressure toward deaveraging, may not have long-term potential, but, at least until the middle of next year, access charges will continue to be pooled, and intralata toll revenues will continue to be pooled, which has the effect of continuing some of the averaging and, therefore, lowering some of the high cost area.

Mr. **Dreier**. Commissioner, has the State legislature gotten involved in this question specifically? Have they addressed the problem of the protection of minimum service?

Mr. **Fischer**. There have been bills introduced and there have been generic investigations of a number of utility issues. But at this point in time we have not had any recent legislation specifically designed to address the question. For example, in some States like Arkansas there have been intrastate universal service fund legislation enacted. That has not happened in Missouri, but I know many of the State legislators are very concerned about the question.

Mr. **Dreier**. Do you think the likelihood of that is pretty great, or what is your view?

Mr. **Steinmeier**. I think it would be my opinion that they are waiting to see what is happening with the State public service commission and at the Federal Communications Commission.

Mr. **Dreier**. Like Congressman Skelton, I have many more questions, but in recognition of the time factor, I thank you very much, Mr. Chairman, and thank you again.

Mr. **Wyden**. Thank you, Dave.

Just a couple from me, Commissioner. Ike, I think, touched on one of our principal concerns—looking at how costs are assessed. the inability to get a handle on these numbers has been, I think, one of the things that has been frustrating in terms of trying to put together some recommendations.

Now, if we were to come into your office, could you take down a set of papers and say, well, Congressman Skelton, Congressman

Wyden, here is the information that we needed to look at costs and we got it, and here is how it works and here is how we set rates based on that, could you do that for us?

Mr. **Steinmeier**. I don't think so.

Mr. **Wyden**. Let me just follow this up again. Are we just taking a stab in the dark? I mean I had my public utility commissioner in the State of Oregon about 2 weeks ago where we had been talking about measured service basically say that we really do not know what the costs are. He felt that we ought to set rates a little bit higher just because we do not know what the costs are; and at some point when we know a little bit more about them, we will just shove them downward. Naturally, some of our small business constituents came to us and said we may not be around when they get around to shoving them downward. I wonder if we do not need some new tools to get a handle on these costs because you and everybody else seems to say we are just taking a stab in the night. Is that true?

Mr. **Steinmeier**. That might be something of an overstatement, but there is certainly a lack of precision and unanimity in the development of telephone costs. Mr. Persinger might be able to elucidate.

Mr. **Wyden**. Tell me what we are getting and what we are not getting that we ought to have.

Mr. **Persinger**. One of the very difficult problems we face is with the divestiture. We have a great deal of difficulty in determining actual costs. Since the first of the year we have been working to get accurate plant figures and things like that from Southwestern Bell, which was, of course, divested from AT&T. That procedure is developing, but it is still in sort of its embryo stages.

We are working at the Commission with a simulated model for access charges which was developed by the National Regulatory Research Institute and which has various types of rates, the access charges and intrastate rates, which now have to be interlata as well as intralata, interstate rates, basic charges, basic exchange rates. All of these factors interact and create situations which may cause customers to drop off the system. We have alluded to that in Chairman Steinmeier's written comments somewhat, but we hope with this model that we will be able to give you some more specific answers. We do not expect to have the data to make that model run until probably sometime in November.

Mr. **Wyden**. So as of now we really do not have a handle on the costs; but maybe with this model, we will start to have a handle?

Mr. **Fischer**. Basic exchange costs, it is true, have always been residually priced, and consequently you determine the things for which you have definite costs, and then the rest of the revenue requirement is obtained from basic exchange service. That is a procedure that has been used historically because local exchange service is not measured, for the most part it is not measured. It is difficult to get a handle on that cost. It was not necessarily essential in a monopoly situation. So that is the problem we face in trying to get a handle on costs in a very short period of time.

Mr. **Persinger**. Congressman, if I might, I think one of the major issues that currently exists right now is not what is the cost, but there are some costs in the telephone system that are shared costs, and the issue becomes if you have several services that use that cost, for example, local loop, I use that whenever I make a local telephone call, and I also use that same local loop when I make a long-distance call. We know what the cost of that loop is, but what is fair for determining how you allocate that between long distance and local, and I think that is the major issue that the access charge decision by the FCC is trying to deal with, and I think that is one of the major areas where State regulators have a disagreement.

Mr. **Wyden**. The only problem is, until you get all the costs on the table with your new model, you cannot begin to get into the fairness issue in a responsible kind of fashion.

I just have one other quick question. Mr. Commissioner, you noted that local telephone rates are going to rise substantially, and you told Congressman Skelton that you could not calculate exactly. What is the lowest percent they are likely to rise in the next couple years, 100 percent, 50 percent, what would be your low figure in the next couple years?

Mr. **Steinmeier**. In the *Southwestern Bell* case last year, the company had originally requested what would have been a doubling of the local exchange rate. In that case, the commission, in fact, raised local residential rates $2.05. That was on top of about $9.45 rather than—in other words, a $2 increase instead of a $9 increase. That is the only specific case other than this small rural company that I referred to in my testimony.

Mr. **Wyden**. I understand that, but in your testimony you said that local telephone rates are likely to rise substantially, so we are not talking about the past. Give me your bottom line on what is going to happen in the future, not the high figure, the bottom line.

Mr. **Steinmeier**. I just cannot, no.

Gordon is mentioning that as the more profitable markets are shared under the forces of competition, there are fewer revenues to offset remaining costs, and that is a problem that you have heard addressed many times; but to give you a minimum figure, I do not know what it would be.

Mr. **Wyden**. I just want to know how you came to make that statement.

Mr. **Steinmeier**. How we decided it was substantial?

Mr. **Wyden**. Yes.

Mr. **Skelton**. Would it surprise you to see the costs increase 50 percent within the next year?

Mr. **Steinmeier**. Within the next year?

Mr. **Skelton**. Yes.

Mr. **Steinmeier**. For some companies, that is certainly a possibility.

Mr. **Skelton**. Would it surprise you to see some of them double within the next 2 years?

Mr. **Steinmeier**. At the moment, no.

Mr. **Skelton**. That would not surprise you?

Mr. **Steinmeier**. No, sir.

Mr. **Wyden**. All right. I think that at least gives us an idea of what might be a conservative kind of figure, and, of course, the implications for that are very serious. The Perl study that was done in this area indicates a 100-percent increase in local telephone rates results in a loss of 3.2 percent of residential telephone users.

In response, then, to Congressman Skelton, you would not be surprised with a 10-percent increase in the next couple of years by some of the companies?

Mr. **Steinmeier**. By some companies.

Mr. **Wyden**. OK. We thank you all very much.

[Mr. Steinmeier's prepared statement follows:]

PREPARED STATEMENT OF WILLIAM D. STEINMEIER, CHAIRMAN, MISSOURI PUBLIC SERVICE COMMISSION

My name is William D. Steinmeier and I am the Chairman of the Missouri Public Service Commission. On behalf of the Commission, I wish to thank you for scheduling this regional hearing to obtain first-hand information from parties who are interested in the very important subject of this hearing, the effect of changes in the telephone industry on small businesses, rural telephone companies and telephone company customers, in general.

I wish to first state that the Missouri Public Service Commission has before it at this time a number of cases and matters which are related to the changing telecommunications environment. Therefore, my comments will necessarily be quite general in natur and will attempt to express to you the concerns the Missouri Commission has for telephone users in the State.

The Missouri Public Service Commission has addressed some of these matters in cases which have already come before it, and where decisions have been rendered, I will include specific references to some of those cases. I will relate to you the direction our Commission has chosen in some of the areas on which you are seeking information.

Of particular significance is the Report and Order in the most recent rate case filed by Southwestern Bell Telephone Company. In Case No. TR-83-253, our Commission had before it a request for an annual rate increase of $254.8 million, the largest increase proposal in subscriber rates to date, as well as the proposals to implement the divestiture of the regional Bell operating companies (BOCs) as required by the court decision which accepted the agreement between AT&T and the Department of Justice for settling the anti-trust suit against AT&T.

Access charges, one of the subjects on which you seek additional information, were a significant issue in this particular case. There is a great deal of debate today over the effect of access charges proposed by the FCC on local telephone customers. This situation is aggravated by the fact that the access charge decision of the FCC occurred at a time when the telephone industry was experiencing unprecedented changes in other areas, including the deregulation of customer premises equipment (CPE), the mandate of the courts and the FCC to develop competition in the long-distance markets and the changes which have resulted from the divestiture of the BOCs by American Telephone and Telegraph Company (AT&T). The FCC has also enacted changes in depreciation practices and has made decisions to treat as current expenses costs that were previously capitalized. Of course, we acknowledge that inflation and other increases in the costs of providing service over the past few years have also caused some local rate increases.

All of these activities in the industry are placing pressure on regulators to deaverage and restructure rates. While some may benefit from these changes, our major concern continues to be whether or not telephone service will be available to most customers at affordable rates. We believe that prices that are implemented at the federal or state level should continue to meet the public interest standards of the Communications Act of 1934, which recognize that a primary objective for utilities is universal service at reasonable rates.

Pressure on the industry to deaverage and restructure rates also is heightened by changes in technology. The installation of digital switching and microwave and fiber optics transmission facilities have greatly reduced the cost per circuit mile for many of the high volume routes. Average rates which have been used by the telephone industry for many years, combined with the FCC's actions to "deload" toll rates at the interstate level, have created fertile ground for competitive communications operations, but have also created concerns and problems for regulators and local exchange telephone companies. The crux of this concern stems from the fact that as competition increases for services on the toll networks, the rates for those services will be forced toward costs and less revenue will be available to cover the common costs associated with the provision of telephone service. Rate deaveraging is also addressed elsewhere in this testimony.

Though technological developments have mushroomed in toll service facilities, except in the instances where electronic digital switches have been installed, and acknowledging that technology has improved the quality of the facilities being used, local exchange service is being provided in much the same manner today as it was 15 or 20 years ago. This means that the average customer is still receiving service over a pair of wires extending on a circuit from the local exchange company office to his business or residence location (i.e. a "local loop"). This may be one of the major reasons that the rate pressure in the new environment seems to be building on the local customer and basic telephone service rates.

Independent telephone companies (non-AT&T or Bell companies) have two basic sources of revenues, local service and toll service revenues. If the current trend toward deaveraging of rates continues, we can expect that both local exchange rates and toll rates for the small and rural companies will increase at a rather high rate because these areas generally have considerably higher costs per customer for the fixed facilities required to provide service of any kind. At the present time, Missouri has 48 telephone companies, of which 37 have less than 5,000 access lines. Even though Missouri has several major metropolitan areas, much of our territory is rural in nature with low subscriber density and few large businesses or industries. At the present time, there does not appear to be a technology in the wings which will make a substantial downward difference in the cost of providing telephone service to customers in rural Missouri.

In the following testimony, I have addressed concerns as stated in Mr. Wyden's letter of July 31, 1984 and some additional concerns which the Missouri Commission may have which relate to the work of your committee.

AT&T DIVESTITURE

Although the Modification of Final Judgment (MFJ), which required the divestiture of the BOCs by AT&T, had many requirements, perhaps the one most pertinent to this discussion is the requirement for "equal access" for all inter-exchange carriers to the communication network. This had the effect of encouraging competition on the switched network, forcing an acceleration of the processes necessary to accomplish this feat. At the heart of the matter is the procedure used by the FCC to allocate costs of common plant between state and federal jurisdictions, commonly known as separations.

Separations is the process of identifying and assigning (or separating) a telephone company's (telco's) plant investment, expenses, taxes, and reserves between the interstate and the state jurisdictions for ratemaking purposes. Prior to divestiture, the AT&T Company provided both Message Toll Service (MTS) service and local exchange service and separations was the tool used to assign plant investment, expenses, taxes, and reserves to each jurisdiction. The basis for the assignment to the jurisdictions was the use of plant needed to provide that service to that jurisdiction.

It has been effectively argued that the estimates used in the separations allocation procedures were faulty and arbitrary. It has also been argued that the accounting system used by AT&T was so complex that accurate separations results were impossible. Therefore, if assignment of costs to the jurisdictions was arbitrary prior to divestiture, it follows that after divestiture it could be even more arbitrary, because the accounting system subsequent to divestiture must necessarily be even more complex.

The local loop used to provide service for toll and local exchange services is considered to be a shared cost. That is, the same piece of equipment is used to furnish both local service and toll service, and since the accounting system does not record common costs by jurisdiction, the assignment of costs associated with a single piece of equipment that provides local and toll services is an arbitrary assignment.

In TR-83-253, the Commission concluded that need for a portion of the rate increase was a result of divestiture. The duplication of management costs and the reduction in settlements revenues to Southwestern Bell are examples of divestiture related costs. But, with separations procedures that are "best guess" estimates and allocation procedures for common costs that are arbitrary, it is still very difficult, if not impossible, to ascertain the long term effects of the AT&T divestiture. The total annual increase granted to Southwestern Bell in the last rate case was $181.6 million, exclusive of franchise and gross receipts taxes and AT&T Communications received $5.3 million in additional revenues. We feel very sure a larger portion of these increases was due to the action of the FCC and the courts than could be directly assigned during the case.

Another area of concern relating to the AT&T breakup is the assignment of costs relating to the breakup and implementation of the MFJ. For example, there is currently much attention being given to which party, the BOC or AT&T, is to recover the cost of network reconfiguration and equal access. There is also a dispute between AT&T and the BOCs relating to AT&T's share of the contingent liabilities and other disagreements, including the allegation that the BOCs were divested with inadequate cash. These pending problems make it difficult to determine the effects of the AT&T divestiture.

Another potential conflict associated with the AT&T divestiture is the relationship between the BOCs and their Regional Holding Companies. The Regional Holding Companies (RHC) have requested the courts to waive the "line of business" restrictions that are contained in the MFJ. All of the waivers requested by the RHCs pertain to the RHCs venturing into unregulated markets, including the long distance market.

There are many problems that arise from these requests. First, the RHC may divert capital and labor away from its commitment to equal access (as prescribed under the MFJ) in favor of more profitable ventures. Second, there is potential danger for cross subsidizing competitive ventures through improper allocation of costs, transfer of assets, and revenues from the regulated local exchange, all of which would be difficult to detect. Some RHCs have stated they have limited interest in the telephone business. Local rates may be affected by these operations if safeguards are not established to prevent financing competitive ventures with rates from the local ratepayers.

Fortunately, Judge Greene of the United States District Court for the District of Columbia, Civil Action No. 82-0192, Misc. No. 82-0025 (PI), Opinion, July 26, 1984, has so far refused to grant these waivers, but has stated that these waivers may be granted in the future when the relationships between the BOCs and RHCs are more clearly defined.

The industry must have its shakedown, old separations procedures must be replaced with new procedures, the proper allocation of shared costs must be addressed, and finally the controversies related to divestiture-related problems must be resolved. Then, state regulators can more accurately determine the ultimate effects of divestiture.

This is not to say that divestiture has not created new problems and a great deal of uncertainty in the utility regulatory process. As recently as last year, Missouri had no OCCs certificated to provide services in competition with the basic exchange service companies nor did we have any applications for such authority. In Part I of the Report and Order in Southwestern Bell's most recent rate case, TR-83-253, the Commission required all other common carriers (OCC) or WATS resellers doing business in Missouri to file applications for certification with this Commission no later than

January 31, 1984. As a result of the Commission's order, the Commission has received thirty-two (32) applications from companies requesting certification for toll intrastate business in Missouri. Twenty-eight (28) of the applications are from companies seeking to resell WATS.

The Missouri Public Service Commission has not only the authority and responsibility to assure that customers of the regulated companies receive safe and adequate service at just and reasonable rates, but that these rates be sufficient to allow the investor an opportunity to earn a reasonable return on his investment. For this reason, one of the primary issues which must be considered in the process of certificating resellers and/or OCCs in Missouri is the economic effect their operations will have on the viability of the local exchange telephone company and ultimately the local exchange telephone end users.

In the last Southwestern Bell rate case (TR-83-253), the Missouri Public Service Commission established two mandatory intrastate toll pools whose joint participants are Southwestern Bell and all other Missouri certificated independent telephone companies. These pools are scheduled to operate through June 30, 1985, and basically replace the pre-divestiture method of toll settlements used by Missouri telephone utilities to allocate toll revenues within the State boundaries. Stated simply, one of the ultimate results of divestiture and competition may be that some part of revenues which are siphoned away from the basic exchange companies by competitors may have to be replaced by increasing the customers' local exchange rates.

Subsequent to divestiture and other developments in the industry, the customer faces a number of changes which were previously unnecessary. One such change is the manner of billing for services by the various companies now providing service. Prior to the divestiture of the Bell Operating Companies from AT&T, Southwestern Bell billed for all telephone services, including local exchange service, equipment, toll and taxes and had the authority to disconnect for nonpayment of these telephone services. Just prior to divestiture, with no procedure in effect by which to bill its customers, AT&T approached Southwestern Bell and requested Southwestern Bell continue the practice of including interstate long distance and equipment leasing to be provided by AT&T on the bills of Southwestern Bell's customers. Southwestern Bell in turn requested that the Missouri Public Service Commission grant Southwestern Bell the authority to buy the Accounts Receivable from AT&T and continue to bill its customers for equipment and toll services provided by AT&T.

In an effort to accommodate the transition to the new system, the Commission approved this procedure and required the telephone companies to itemize all telecommunications services and applicable taxes for each company providing said services. The Commission's rationale in approving this was two-fold: (1) To continue to provide a customer with one telecommunications bill; and, (2) to allow Southwestern Bell a means to generate additional revenue to help offset some of the loss of revenues resulting from divestiture.

The change in billing was one of the most prevalent subjects of criticism received from telephone customers in Missouri after the implementation of divestiture on January 1, 1984. Customers perceived this billing format change to be unnecessary, confusing, and costly.

Instead of a two or three page bill, his postdivestiture bill consisted of six to eight pages with no apparent change in service. After discussions involving the Commission and its Staff, Southwestern Bell modified and simplified its billing format as of May, 1984. We are monitoring customer response to those changes. As an example of where this may go, I note that Southwestern Bell Telephone Company has now advised us that effective August 1, 1984, an administrative decision has been made to include bill stuffers for non-regulated services in the monthly mailings to customers.

ACCESS CHARGES

The FCC's access charge decision is an attempt to alleviate many of the problems associated with the separations process which I discussed earlier. Basically, access charges will be paid by interexchange carriers (IX) to the local exchange companies for use of the local companies' plant required to complete or terminate their calls. The access charges paid by IX carriers will recover traffic sensitive costs (i.e., costs that are related to usage) incurred by the local company. Non-traffic sensitive costs (i.e., costs that do not vary with usage) are to be borne by the end-users through a flat-rate customer access charge.

The question now becomes, "What is the effect of access charges on local rates?" The most obvious and direct effect is the end-user charge mandated by the FCC. A $2/month charge on residential and $6/month charge on business lines will simply raise the rates to customers by that amount.

In TR-83-253, the Missouri PSC flatly rejected a proposal to establish customer end-user charges for intrastate services.

> "The Commission finds that the cost of a local loop can arise from a demand for local and/or long distance services and therefore should be recovered through at least local exchange, carrier access and toll services. To announce that economic efficiency requires that interLATA toll carriers be provided with free access to the local loop is patently absurd. The FCC Plan which intends to place virtually all costs associated with the local loop on end-users is contrary to public policy in that it threatens the goal of universal service. Therefore, the Commission rejects the imposition of a similar plan for intrastate Missouri telecommunication services."

(TR-83-253 Report And Order Part I, page i).

Access charges paid by IX carriers will affect local rates if the revenues received do not match the costs that the telco incurs. If access charges exceed the cost of providing access, then a subsidy will flow to local rates. If the cost of access is greater than revenues obtained from the IX carriers, then local rates will go up. It is quite clear that separations will again be the tool to determine the amount of costs assigned to the jurisdictions. And as previously discussed, separations procedures are continually changing to adapt to a post-divestiture environment. Therefore, it is difficult to estimate the future effects of access charges on local rates of any type.

A good example of the effect of access charges on business customers is demonstrated by taking a look at the treatment of private branch exchange (PBX) and Centrex services, one of which is normally the heart of a business communications system. The FCC's access charge decision, assessing all business customers a $6.00 fee for access to the system, had a dramatic effect on business customers who were using Centrex C.O. systems, and gave a decided advantage to PBX customers, even though the FCC reduced the $6.00 business charge to a $2.00 per line charge for Centrex C.O. systems.

For clarification, let me first explain the technical difference between a PBX and Centrex C.O. A PBX is usually located on the customer's premises and switches all of his stations among themselves and provides for connecting them to the outside world through a limited number of outside trunk lines between his business and the company's central office. For instance, a customer may have 1,000 phones in use at his business, but because those phones are never all in use at the same time, he may only require 100 trunk lines or pairs of wires to the company's central office. On the other hand, a Centrex customer is served via the company's central office switch and therefore, is required to have a pair of wires for each and every telephone set in his place of business. Therefore, using the same example, the business customer having 1,000 telephones would be required to have 1,000 dedicated pairs of wire running to the company's central office. Since the FCC's access charge is levied on each pair of wires from the central office to the location of the business customer, obviously a competitive advantage is given to a business customer who is utilizing a PBX.

In March of 1984, Southwestern Bell Telephone Company introduced Centrex III, a service offering designed in such a manner that a customer may subscribe to a Centrex system that more nearly approximates the grade of service provided by a PBX. This proposal was approved by the Missouri Public Service Commission, but did not circumvent the FCC's decision to assess a $2.00 per line fee on each single pair of wires between a business customer's premises and the company's central office. All it really did was eliminate some of the contribution or profit to the telephone company for this service in an attempt to keep the customers on that service. In fact, the Company, the PSC Staff and the Office of Public Counsel generally agreed that this repricing of Centrex C.O. service would result in a net loss to Southwestern Bell, but was preferable to losing more Centrex C.O. customers and leaving stranded investment resulting in even greater losses.

Another quirk in the FCC's access charge plan concerns the way the FCC has interpreted its order as it applies to business customers. The FCC has determined that any business with more than one line will be assessed the access charge, regardless of whether all lines terminate at the same premises. For instance, the post office may have one phone in a small rural community, but because the FCC views that post office as just a branch of the United States Postal Service, the local post office with one phone would also be assessed the access charge fee. This interpretation of the order seems to be detrimental to small business operations.

The FCC's rationale for the access charge relates to its determination that cost responsibility for non-traffic sensitive (NTS) telephone plant should be shifted from the toll rates on a usage basis to the local exchange user on a flat rate basis. NTS plant is basically the pair of wires between a customer's station and the central office from which the station is served. As an example of the significance of this action on small companies, I will cite from a specific rate case. During calendar year 1984, the Commission heard one small telephone rate case from a two-exchange telephone company located in northwest Missouri, serving approximately 650 customers, in which the telephone company requested and was authorized an $18 residential local exchange rate and a $31.50 business one-party rate. Permanent rates were previously $4.25 and $7.00 per month, although interim rates of $11 and $19.25 were in effect for about a year prior to the decision on new permanent rates. This increase was deemed necessary because of the company's investment in plant associated with a recent construction program which basically involved rebuilding outside plant and upgrading to all one-party service. The company replaced 99% of the outside plant, which included 155 miles, at a cost of $1,097,144.

Based on testimony filed in that case by the Missouri Public Service Commission Staff, the cost of providing NTS telephone plant to a subscriber living inside the community limits of this small telephone company's service area was $6.14 per month, whereas, the average cost for a subscriber living outside the community limits in the same area was $55.43 per month. The intent of this example is to show how large a portion of its total investment NTS plant may be for a small rural company and why the Missouri Public Service Commission is concerned with the obvious intention of the FCC to deaverage local exchange service and, to use a cliche, cause the cost causer to be the cost payer.

Another point that should be made is that switched access charge tariffs just recently went into effect (May 25, 1984) and special access charge tariffs are still under suspension and finally, the end-user access charge, the most controversial element of the access charge order, has been suspended until June of 1985.

Therefore, until all access charge tariffs are effective and we have had time to accumulate some experience with them in place, it would be inappropriate to try to determine their ultimate effects on the telecommunications industry.

However, the Missouri PSC is working to develop a tool to assist it in the evaluation of the AT&T divestiture, FCC access charge decisions in CC Docket 78-72, changes in separations in CC Docket 80-286, and other changes in the telecommunications industry. The tool is called, "A Simulation Model on Access Charges" (SMAC) and was developed in 1983 by the National Regulatory Research Institute (NRRI) during its study of the effects of access charges on ratepayers. Implicit in the data used in the model are the effects of the AT&T divestiture and separations changes mandated in CC Docket 80-286.

SMAC recognizes current federal decisions and their relationships to institutional factors, economic factors, and state policies. The model also contains feedforward and feedback loops to encompass subsequent effects of the federal decisions. For example, if the FCC imposes an end-user charge on customers, some individuals are expected to change their usage patterns in both the interstate and intrastate markets and some individuals will probably drop off the system. Since the separations process allocates plant on usage to obtain a portion of the revenue requirement allocable to interstate jurisdiction, these changes in usage will affect rates. Also, since people may drop off the network, there will be a smaller customer base over which to spread fixed costs. Therefore, rates go up, usage patterns change again and some subscribers will drop off again. This cycle will repeat itself until an equilibrium is reached.

SMAC was developed and the results published in a pre-divestiture environment. Currently, the Missouri PSC staff is obtaining post-divestiture data from Southwestern Bell Telephone Company. This data is expected in mid-October. Our staff expects to have an edited post-divestiture version of SMAC up and running by December of this year. At that time, various "What If" scenarios can be run, which will place the Missouri PSC in a position to better ascertain the effects of the AT&T divestiture, the FCC access charges, and other changes in the telecommunications industry, on local rates.

SMAC incorporates a variety of parameters that will allow for evaluation of direct and indirect effects. SMAC will give us the capability to look at the deeper effects of federal decisions through the feedback and feedforward loops. The escalation of effects on local rates can finally be evaluated properly without all the rhetoric of what policymakers "believe" will happen. We believe SMAC will add credibility to our methods for reviewing the costs and effects of federal actions.

OTHER CHANGES IN TELEPHONY

There has been dramatic movement over the last several years toward reliance on competition, whereever possible, to control the telecommunications industry. The concept of competition will have two significant effects on telephone rates.

The first effect is the deaveraging of toll rates and the corresponding effect on local rates that results from competition. Historically, telecommunications services have been priced so that customers will pay approximately the same price for like telecommunications services over like routes regardless of the difference in the cost of providing the services over those routes. This concept is called rate averaging.

Rate averaging was developed because policymakers determined that society as a whole was better off if everyone could use the telephone network. Unfortunately, some segments of the market are more expensive to serve than other segments. Rate averaging allowed all users of the network to pay like rates for like services and thus it was deemed the most equitable method of achieving the goal of universal service at affordable rates.

If rates are set by competition, then they must reflect costs. If rates reflect costs, deaveraging of rates occurs and some rates will go up for certain areas (i.e. the low volume, high cost rural areas). Thus, two customers making calls over like routes could be charged substantially different rates due to the different costs to provide the service.

The second major issue that results from competition is that of a provider of last resort. Currently, a certified telco in Missouri must provide service to everyone within the geographical area outlined in its certificate. Since the telco must serve everyone, competing firms are excluded from the market. Due to actions in the interstate arena, the FCC and federal courts are putting pressure on states to open up intrastate markets to competition. This raises the question of whether or not we can sustain the "provider of last resort" policy in a potentially competitive environment. In other words, can we prevent a local carrier from refusing service in some areas?

The concept of competition allows unrestricted entry and exit of firms from the market. Therefore, if prices are above costs, and the telco is making a profit, you are likely to see firms entering the market. If prices are less than costs, thereby reflecting losses, you will likely see telcos leaving the market.

Under the conditions of competition, any carrier that provides service to the rural communities must provide that service at cost. If it is provided above cost, then presumably other carriers will enter until rates reflect cost. If rates reflect cost, but the cost is extremely high, customers will drop off the network leaving less customers to pay those costs and thus rates go up. If the carrier realizes this problem, that carrier should be allowed to leave that market under the conditions of competition.

Under the conditions of competition, carriers are allowed to enter markets of their choosing. If no carrier chooses to serve a particular market, that is its prerogative. But would all this be in the public interest?

The end result of rate deaveraging and the entry and exit of firms is that high volume, low cost routes should experience a decrease in rates while low volume, high cost routes could see an increase in rates. In the extreme, if rates go too high, one could observe telcos leaving the market and leaving communities without telephone service.

Technological changes in the telecommunications industry can also affect telephone rates. For example, the application of electronic and digital switching and the introduction of fiber optic transmission systems has helped reduce prices in the toll markets. AT&T has lowered its interstate rates by 6.1% and MCI has lowered its rates by 6.0%.

Cellular mobile phone service is another area in which technological change could affect local rates. The Missouri legislature, during its last session, passed a bill to deregulate mobile paging and cellular phones which will become effective on January 1, 1986. Cellular service may ultimately provide a vehicle which allows its users to bypass at least a portion of the local exchange network, and that service will be unregulated.

The effects of the changing communications environment and the confusion it is causing surfaced recently in Missouri when a Southwestern Bell customer sought to install privately-owned coin telephones in his business, resell local coin service at different rates than those approved for Southwestern Bell, and obtain service via the basic business rate which is residually priced and not necessarily based on the cost of service. Historically, there has only been one provider of local exchange service. However, with the new environment and with the recent decision of the FCC to include the new vintage of "smart" coin operated phones in its registration program, state regulators must now decide whether it is in the best interest of the general body of ratepayers to allow resale of local exchange service via non-telephone company owned equipment.

The issue of jurisdiction in Missouri on pay telephones was tested this month in Kansas City circuit court. The court ruled that the jurisdiction was with the Missouri Public Service Commission and denied the plaintiff's request to have the court order the local telephone company to give him service for his coin telephones.

The new technology in coin operated telephones has opened up new opportunities for customers and new problems for local exchange companies and regulators. The "smart" instrument may be programmed with fairly complex rate tables which charge the customer on a flat rate local calling basis, usage local calling basis, and/or usage long distance calling basis. Most of the present coin instruments utilized by the telephone companies require an operator to advise the ratepayer of the applicable rates. We must decide whether authorizing this type of service will be detrimental to the local telephone company's capability to continue to provide basic service at affordable rates.

The preponderance of telephone service in rural Missouri is provided via electromechanical switches which may be of the 1950, 1960 or 1970 vintage. Much of this equipment provides adequate voice grade services, but does not provide customers with the latest state-of-the-art communications features, such as Call Waiting, Call Forwarding and Speed Calling along with other features that may enhance transmission of computer data.

While a majority of customers may be satisfied with standard voice grade service, sometimes called plain old telephone service (POTS), some customers in practically every area are seeking more sophisticated capabilities from the telephone network. To provide this new technology will require rural serving companies to install millions of dollars worth of "state-of-the-art" equipment, for which they will seek the rates necessary to cover these costs from their customers. The question this Commission must consider is whether the changes are cost-justified and in the best interest of the general body of ratepayers in Missouri.

Due to a number of relatively recent FCC actions, the establishment of depreciation accrual rates for some portions of the telephone industry have been preempted by the federal agency and these increases in depreciation requirements have flowed through to customer rates. There are a number of valid reasons for increasing depreciation rates, regardless of the procedure used for the actual calculation, but the most significant effects of depreciation rates have been due to changes in the procedures used to calculate the rates.

The competitive environment in the communications industry has created great pressure on depreciation rates. Depreciation rates are designed to recover the costs of a particular asset during the life of the asset and that recovery is a portion of the rate paid by the customers, in the case of utility companies. In a competitive environment, the utility companies lose most of the control they previously had in a monopoly situation over obsolescence. In other words, there is a great rush to bring out new and more sophisticated equipment and in a competitive environment, only vendors who have equipment with that capability will be able to capture a share of the market. Therefore, although telephone companies have large quantities of electro-mechanical equipment, standard telephones and other conventional equipment which is still serviceable and may be for a number of years, there is pressure to replace the existing equipment with more modern equipment, thereby reducing the average life of the equipment and increasing depreciation requirements.

Regardless of whether or not we have control of specific depreciation rates, the Commission is being called upon with some regularity to authorize replacement of "technologically obsolete" central office equipment and other types of communications gear so that telephone companies can offer "state-of-the-art" service. These are particularly difficult decisions for regulatory commissions to make, because they smack of "managing" the company, and yet, we cannot shirk our responsibility to the ratepayer who must eventually pay the bill.

In response to your questions as to how depreciation rates have affected customers' bills, I will again cite some general observations, since the actual effects of the changes which have been enacted and the changes which are still pending cannot yet be accurately determined. When the FCC took steps to deregulate customer premises equipment (CPE) and phase the depreciation of such equipment out of the separations process over a period of five years, most telephone companies in Missouri applied for and obtained higher depreciation accrual rates to compensate for the change. While the net effect, due to certain peculiarities of the separations process, was not significant in every case, the expected result of higher depreciation accrual rates is an increase in customer rates for service.

Until a recent action of the Federal Communications Commission which authorized the use of Equal Life Group depreciation procedures, the Average Service Life method of determining depreciation rates was used. The change to ELG procedures caused an immediate increase in depreciation reserve requirements, which translated directly into higher rates for customers. AT&T and perhaps other segments of the telephone industry are now advocating a new procedure for depreciation rates called the Straight Line Age Life procedure. While advocates of the process contend it is necessary to more correctly align depreciation reserves with plant and equipment lives, the effect of a total change to this procedure has been estimated to be an increase in depreciation accrual rates of approximately 60%. This will translate directly into higher rates for customers of telephone company services.

Depreciation expense is a significant portion of any telephone company's cost of serving the public, because utilities are capital intensive in nature. Regulators must seek reasonable procedures and rates which allow the companies to recover investments over their expected life, but at the same time insure that customer interests are not jeopardized by proposed changes in depreciation rates which are designed simply for the purpose of financing company ventures into new areas or the purchase of sophisticated equipment for which it has no demand.

The real dilemma for us and the local exchange telephone companies in a competitive environment is how to keep up with the rapidly changing technology in order to maintain a share of the competitive market and at the same time recover the cost of obsolescent plant. It seems this is one question which we should answer before we throw open the local exchange network to unlimited competition.

While the joint use nature of most telephone facilities makes some universal treatment advisable, state regulators generally believe the FCC should concern itself with the establishment of guidelines for establishing depreciation rates, rather than the preemption and actual setting of rates for services which are predominantly used for local and intrastate services.

The Missouri PSC is very concerned with these issues and how they relate to local rates. In Missouri, local rates are residually priced. This means that the telco comes before the Commission with an intrastate revenue requirement. After the Commission has determined how much toll rates, access charges, etc. will change, that amount is subtracted from the intrastate revenue requirement and whatever is left over (or the residual) is made up in changes in local rates. Therefore, any changes to toll rates and other services due to competition, changes in technology, changes in depreciation practices, will consequently affect local rates.

BYPASS

The Commission stated in its Report And Order of Southwestern Bell's Case No. TR-83-253 issued November 22, 1983,

> "It is clear to this Commission that competition in the provision of telecommunications services exists and appears to be growing. Competition which results in the avoidance or bypass of the local switch network could result in stranded investment, leaving more telephone plant to be paid for by fewer monopoly customers through higher local rates. On the other hand, the shifting of NTS costs to end user customers could encourage users of local service to bypass the local switch network or to leave that network entirely. Therefore, the task before the Commission is to try to establish just and reasonable rates for telecommunications services which recover the cost of those services including a proper portion of local loop costs, without encouraging uneconomic bypass."
>
> "The Commission determines that developments in bypass technologies and in specific or "targeted" bypass potential should be carefully monitored. In addition, the Staff, Public Counsel and Company should meet, as recommended by the Staff in its

> brief, to attempt to establish a reasonable mechanism for regulatory response to specific or targeted bypass "threats" as they may materialize in relation to major Southwestern Bell business customers."

As a result of this order the Commission has received a Joint Recommendation of Staff, Office of Public Counsel and Southwestern Bell Telephone Company which provides that Southwestern Bell Telephone Company and all other exchange telephone companies and interexchange carriers will monitor bypass in Missouri. The process requires a report which includes the revenue impact of the bypass, the date the bypass occurred, the number of facilities that were bypassed, the name of the company where the bypass occurred, the type of the bypass system (i.e. microwave, fiber optics, etc.) and the nature of the bypass (i.e. economic, uneconomic or technological).

To attempt to fashion a pricing structure by regulation designed to discourage bypass without distinguishing whether the bypass at issue is economic or uneconomic (or technological) could result merely in the shifting of additional costs to the end-user, while ultimately discouraging not a whit of bypass because the bypass in question proved to be "economic" or "technological". This summarizes the regulator's dilemma, in my view. And in dealing with that dilemma, we, as state regulators, will continue to strive to be responsive to the changing marketplace, seeking out the best information that can be presented to us as to whether threatened bypass is truly uneconomic and therefore within our power to avoid, or rather is beyond our means to discourage.

ALTERNATIVES TO UNIVERSAL SERVICE

In regard to paying for a universal system, the Missouri PSC noted a universal service fund "may be necessary and desirable in order to promote and preserve universal service by maintaining local exchange rates at reasonable levels." (TR-83-253, Report And Order, p. 32).

The Commission also noted that more information was needed regarding the need for such a fund and a method for financing and distribution of monies from the fund. Until more information is obtained, "the Missouri PSC will closely monitor (1) the impact of the rates authorized in TR-83-253 on universal service in Missouri; (2) the progress of the federal USF; (3) the effects on high cost companies of the shift of interstate NTS costs to end-user customers; and (4) the effects on Missouri telephone companies of the deaveraging of intrastate rates." (TR-83-253, Report And Order, Part II, p. 32).

I realize that I have provided to you a great deal of information, much of which may be considerably more basic than you desire. I trust that throughout this testimony you can detect how very serious we as state regulators believe current trends in the regulation of the telecommunications industry to be.

While it is impossible to tell you how much rates will increase on a per line basis in the future, I trust the information I have provided to you indicates our serious concern for the fact that most of the recent actions of the Federal Communications Commission in the courts have created a trend for a shifting of costs from the interstate jurisdiction to the local end-user of telecommunications services. Simply stated, practically any action of the FCC which reduces the allocation of cost to interstate will cause some increase in cost allocated to the intrastate jurisdiction and ultimately the end-user of communication services.

Generally speaking, the Missouri Public Service Commission believes that small and rural telephone companies do have special problems which must be considered in the establishment of both federal and state policies. The major theme of Missouri Public Service Commission testimony, responses and reaction to FCC action has been a plea to take the time to determine the estimated effects of the actions proposed to be taken prior to enacting something from which there is no turning back. At the present time, we appear to be in a headlong rush toward the virtual deregulation of the telephone industry, with little regard for the question of who will provide services to the remote areas in Missouri and other states where the costs of providing service exceed the capability of a majority of the subscribers to pay. We believe it is mandatory that some long-term plans be made to insure the continuation of service to all who desire telephone service at affordable rates before we actually prove that competition does not work in all situations.

I believe it is essential that members of Congress be aware of the seriousness of the problems your Task Force is addressing and I again wish to commend you for taking the time and providing the opportunity for us at the local level to make our concerns known to you. If the Public Service Commission or its staff may be of service to you in your quest for answers to these very timely questions, please do not hesitate to contact us at any time.

Mr. **Wyden**. Our next panel, Ms. Kay Walker, Mr. Dennis Hogan, Ms. Barbara Ruml, Mr. Tom Youngworth, Dr. Donald Potts, Mr. Timothy Hogan, and Dr. Protzman.

Your prepared statements will be made a part of the record, and please, if you would, just highlight your key concerns.

TESTIMONY OF KAY WALKER, ADMINISTRATIVE ASSISTANT, MISSOURI MERCHANTS & MANUFACTURERS, ACCOMPANIED BY DENNIS HOGAN, EAST SIDE AUTO PARTS; BARBARA RUML, VICE PRESIDENT, MUSIC SERVICES, INC.; TOM YOUNGWORTH, GENERAL MANAGER, CENTURY 21 REAL ESTATE; DR. DONALD POTTS, FAMILY MEDICINE; AND DR. ROBERT A. PROTZMAN, GENERAL DENTISTRY

Ms. **Walker**. Mr. Chairman, members of the committee, my name is Kay Walker, speaking on behalf of Sheelah R. Yawitz, executive director of Missouri Merchants & Manufacturers Association.

We represent 5,000 small businesses throughout the State of Missouri. We certainly appreciate your time in reviewing the recent changes in the telecommunications industry.

Do we positively know that AT&T's long-distance rates have been subsidizing residential and small business users? The current one-line exemption from the access fee charge definitely helps the residential user. Big business will be exempt from the access fee as they can afford to install another phone system which leaves small business picking up the tab.

Please consider replacement of this access fee with a documented prorated fee based on total services provided.

We ask this telephone task force to please look at the telephone access fee in this same light. The financial burden of the telephone access fee is on small business.

[The following was received for the record:]

Missouri
Merchants &
Manufacturers
Association

Political Voice for Missouri's Small Businesses

August 24, 1984

Mr. Chairman and members of the committee, my name is Sheelah R. Yawitz, Executive Director of the Missouri Merchants & Manufacturers Association. We represent 5,000 small businesses throughout the state of Missouri. We certainly appreciate your time in reviewing the recent changes in the telecommunications industry.

Do we positively know that ATT's long distance rates have been subsidizing residential and small business users? The current one line exemption from the access fee charge definitely helps the residential user. Big business will be exempt from the access fee as they can afford to install another phone system. Which leaves small business picking up the tab.

Please consider replacement of this access fee with a documented prorated fee based on total services provided.

Small businesses are very grateful for the Federal Regulatory Flexibility Act of 1980. As you know, the purpose of this act is to ensure that regulators do not burden small units disproportionately by imposing uniform regulations on all entities regardless of size.

We ask this Telephone Task Force to please look at the telephone access fee in this same light. The financial burden of the telephone access fee is on small business!

Sheelah R. Yawitz

SHEELAH R. YAWITZ
Executive Director

***Please note that this testimony will be given by Sheelah's Kansas City Assistant, Kay Walker.

OFFICES:

910 Clayton Road, Suite 322
St. Louis (Ballwin), MO 63011
(314) 468-2061

821 West 122nd St.
Kansas City, MO 64145
(816) 941-9450

430 South Avenue, Room 401A
Springfield, MO 65806
(417) 831-2403

A MISSOURI NOT-FOR-PROFIT CORPORATION

Mr. **Wyden**. Mr. Hogan.

Mr. **Hogan**. Mr. Dreier summarized basically what I have written here in that the access fee discriminates. Our business was virtually doubled in the last 6 or 7 years. We have gone from one parts store to three.

In the parts business, the telephone is your livelihood. At least 60 percent of our business comes in over the telephone. If we are going to maintain our current level, we are going to pay over $85 per month just to maintain our current telephone service.

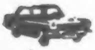
There is not a small business in this country, I believe, that is satisfied with where they are at. If we are going to grow, we do not need obstacles such as this in our way.

In a word, this fee discriminates. The larger companies are not saddled with it.

The auto parts business directly affects or indirectly affects everybody in this room. We are talking about lessening competition with this fee.

Thank you.

[The following was received for the record:]



THE EAST SIDE AUTO PARTS CO., INC.
of
K.C., MO. 64126

231-3544-45
231-3620-22
8011 TRUMAN ROAD

Aug. 15, 1984

To whom it may concern,

Your proposed access fee for telephone service discriminates against small business. It particularly discriminates against any business that relies on the telephone for over 60% of its customers. In the Auto Parts business, people shop for value, with the high cost of parts and gasoline, they shop by phone. If we maintain our current number of phone lines, we will be forced to pay over $85.00 per month in access fee's. If we are forced to cut our phone services due to this fee, it will cause a directly proportional drop in business. I know of no one who wants to hear a busy signal when they are trying to purchase an item. Do you?

Further more, we must add telephone lines as we grow. This fee will stunt our growth, and other small businesses with us. Yet, it will not even effect the large conglomerates with their expensive private systems.

Friends, in a word, this proposed access fee discriminates. If it is passed it will put one more nail in small businesses coffin. So please, do not pass the access fee. You will be penalizing people who can least afford to pay. You will be weaking our competitive free enterprise system.

D.J. HOGAN
EAST SIDE AUTO PARTS

Mr. **Wyden**. Ms. Ruml.

Ms. **Ruml**. Mr. Chairman, Congressman Skelton, and Congressman Dreier, I am Barbara Ruml, with Music Services, Inc., the MUZAK franchise in Kansas City.

Mr. **Skelton**. For the people who do not understand, tell us what that is.

Ms. **Ruml**. This is a service that provides music to small businesses throughout the area, large businesses as well, but mostly small businesses. We provide service to retail stores, hospitals, hotels, restaurants, offices of all sizes.

Mr. **Skelton**. Is this the music that is in the background that takes your mind off the pain that is in your tooth while you are waiting for the dentist?

Ms. **Ruml**. That is right. It is a functional music service. We are 1 of approximately 200 such franchises in this country. We serve the Greater Kansas City area, and we go to Sedalia, St. Joseph, Lawrence, and Topeka, KS, as well. So it is a bistate franchise.

As a result, we are now using an AT&T special tariff 260 to transmit our signal. At the moment we are paying $8.25 per customer for transmitting our music signal. We do not serve all of our customers that way. Many of our customers we serve by FM broadcast. But in some areas which we cannot reach by FM, we use a telephone signal.

The last proposal that AT&T made to the FCC for an increase was for an increase from $8.25 to $65, which is more than some of our subscribers are paying in music fees. It represents a 700-percent increase. We would find this quite intolerable. We would probably have to terminate some of our customers which would deprive these businesses of the benefits of MUZAK. In any case, a substantial increase would have to be passed on to our customers as we could not absorb it ourselves. This is a very significant part of our business and would cause us to have to pass the increase on to other small businesses and, therefore, be damaging to them as well.

Thank you.

[Ms. Ruml's prepared statement follows:]

PREPARED STATEMENT OF BARBARA RUML, VICE PRESIDENT, MUSIC SERVICES, INC.

This statement is submitted on behalf of Music Services, Inc. the owner and operator of the MUZAK® franchise in Kansas City, Missouri. Music Services, Inc. is a small business with a staff of 14 employees which does a volume of business of slightly over one million dollars a year.

The MUZAK® franchise in Kansas City has been serving the area for 38 years. It supplies functional music programs to more than 1500 subscribers including hospitals, shopping centers and retail stores. Most of these subscribers are themselves small businesses that believe that MUZAK® music enhances the working environment by relieving boredom and fatigue. MUZAK® music is broadcast to subscribers over FM and over telephone line networks.

We wish to emphasize that our business will be severely damaged if proposals recently filed by AT&T are approved. These proposals authorize astronomic increases in the present tariff that appear to have no connection with costs nor with the changes required to divest.

In the area we serve which includes Greater Kansas City, St. Joseph, Sedalia and Warrensburg in Missouri and Topeka, Kansas MUZAK® service is distributed by telephone lines for which we pay under the current interstate AT&T Tariff #260 a monthly charge of $8.25 per subscriber line.

AT&T's last proposal was to increase this interstate private line rate of $8.25 to approximately $65 per month per subscriber which would increase the cost of transmission alone in most cases to more than we collect from our customer. An alternative method of transmission would be the BOC's interstate service but the proposed tariff is $152.80 per month per subscriber which is even costlier than the AT&T rate.

Fortunately the FCC is conducting extremely thorough investigations into these proposed rates and the justification therefore.

Telephone line costs are already the single largest direct operating cost in providing MUZAK® service. The magnitude of this proposed increase (700%) makes it impossible either to absorb or to

MUZAK

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SMALL BUSINESS COMMITTEE TELEPHONE TASK FORCE HEARING cont.

- Page Two -

pass on to our customers. If approved, we will be faced with terminating many customers to the detriment of our business and the business of our customers who have benefitted from MUZAK® service for many years.

We greatly appreciate this opportunity to make a statement to your Committee and we applaud your efforts to encourage and assist small businesses such as ours.

Respectfully submitted,

MUSIC SERVICES, INC.

Barbara M. Ruml

Barbara M. Ruml
Vice President

Mr. **Wyden**. Mr. Youngworth.

Mr. **Youngworth**. Thank you.

I am Tom Youngworth, representing Century 21 Heritage. We are located in Overland Park, KS. We are a small real estate company. We have 2 employees in our company, and we have 12 self-employed sales associates with us.

We require four telephone lines as a minimum to conduct our business. We probably ought to have six or seven. Our line cost is about $20 per line. Our average long-distance call for the last 9 months was $90. We are faced with a $24 increase with the access charges.

Like the gentleman here, about 95 percent of our business is related to the telephone, and most of it is local. We just feel that being required to pay a long-distance charge when most of our calls are local tends to discriminate against us.

Thank you.

Mr. **Wyden**. Thank you.

[Mr. Youngworth's prepared statement follows:]

PREPARED STATEMENT OF TOM YOUNGWORTH, GENERAL MANAGER, CENTURY 21 REAL ESTATE

Century 21 Heritage, Inc. is an independently owned and operated real estate company, and currently has a staff of two employees and twelve self-employed sales associates. Our primary market is residential real estate sales in Johnson County, Kansas.

The company's monthly telephone expenses, which includes four access lines and nine telephones is:

1. Access Lines (4)	$122.20
2. Lease/Purchase of Equipment	115.58
3. Long Distance Calls (9 month average)	91.92

As a result of the Federal Communications Commission (FCC) Order of February 15, 1984, effective May 25, 1984, a long distance access fee of $6.00 per business line was added to our monthly telephone bill. This Order increased our long distance costs by $24.00 per month, for an increase of 26.1%. We are obviously not a major user of the long distance telephone systems, and by any criteria, would be considered a small business.

Our concern is that the FCC Order arbitrarily exempted only single line business customers from the long distance access fee, and apparently did not make allowance for the fact that the number of access lines required by a business does not necessarily have any relationship to the volume of long distance useage. Our company, and I suspect many other service intensive small business owners require more than one business line to remain competitive in our local market.

Mr. **Wyden**. Dr. Protzman.

Dr. **Protzman**. I practice dentistry in Jefferson City and have a phone system consisting of three lines. The first is a courtesy phone in our reception room for patients for local calls. The second is an unlisted number connected with Tel-Central which we use for outgoing and long-distance calls, and the third line is our listed number in the phone book.

At this time I am being charged an access charge on all three lines. I have contacted the telephone company on four different occasions, and each time I have received a different explanation.

First I was told it was an access charge for connection of United Telephone equipment to AT&T business equipment.

The second time I was told it was to cover the cost of the line from the office to the United Telephone equipment.

The third time I was told the toll charge was to defray lost revenues from AT&T.

The fourth time I was told it was to cover the cost of depreciation of equipment betweeen my office and United Telephone equipment.

Also, I was told all revenues from Tel-Central at this present time stay with United Telephone. Tel-Central received a notice that AT&T had applied for a 500-percent increase in their rates to 9 cents per minute. That translates back to our current cost of 1.8 cents per minute which is pretty darn cheap communication.

United employees which travel and work closely with AT&T admit their concern over lost revenues when Tel-Central, SPRINT, MCI, et cetera, begin using disk and satellites, and they have no qualms about admitting that they do not want the other companies to succeed.

A United employee even suggested I put one line in my daughter's name, one line in my son's name, leave the current line listed; and as access charges apply only to multiline businesses, I no longer would be charged the access charge.

To paraphrase something Will Rogers once said, "Whenever I tell a joke, it doesn't hurt anyone. Every time someone in Washington tells a joke, it becomes a law."

Ma Bell used to use long-distance revenues to help defray costs of local service. Local service at that time operated at a deficit or at least marginally. When you have a local service operating marginally or at a loss, it helps keep consumer costs at a minimum; and then to expect it to solely provide the same or better service, either somebody works for nothing, or at a loss, or it is forced to raise additional revenues.

I think maybe you ought to consider putting Ma Bell back together and let them run the FCC.

Mr. **Wyden**. Thank you, sir.

[Dr. Potts' prepared statement follows:]

PREPARED STATEMENT OF DR. DONALD POTTS, M.D., FAMILY MEDICINE, INC.

GENERAL: The latest changes in the telephone industry have resulted in several benefits to small businesses: One, it is now easier to purchase equipment-costs are down because of free enterprise operating within what was once a monopoly. Two, some costs are down because there is no longer the requirement to have "interface" and other devices which had to be rented and could not be purchased. Three, people are becoming more knowledgable regarding telephone equipment and their rights. This has resulted in improved technology and increased features available to the small business user. For instance, I purchased a call forwarding device in 1975 at a cost of $800. This feature is now available for a few cents a month.

One of the nicest benefits is that the "phone co" is now getting friendly - they have decreased or eliminated some tactics that had become characteristic of them over the years, resulting in a better image. They will even sometimes negotiate with a customer now!

SPECIFIC IMPACT ON MEDICAL PRACTICES:
Positive: The technology that is available now has resulted in better availability and better communications for physicians. There are more devices becoming available utilizing phone lines, i.e., data transfer, electrocardiograms, etc.
Negative: The negative aspects are primarily financial. For years we have been hearing that businesses had to underwrite residential phone usage. Why was that decision made in the first place and why does it have to be perpetuated? We are told that it's because we use the telephone more, but is there research to support this? Also, as businesses we have to pay for information calls beyond four per month per office, not per phone line.

Let's get down to telephone universal access charges:
I understand that when one makes a long distance call, it may be handled by at least 3 and often more telecommunications companies. I have no great objection to paying a monthly surcharge just in case I ever want to make a long distance call. I do, however, strongly object to subsidizing the Bell companies if I elect to use a different long distance telephone company.

Prior to the Bell system breakup, a charge such as this would have been included as "basic service" and the public would not have been aware of the specifics of how their communications money was spent - now we are a little more enlightened and the small businesses of the U.S. appreciate it. These are philosophical comments, I realize, and they should be so considered.

In my business, I have three telephone lines, primarily so that someone in an emergency situation will not have to wait long to contact the office. The majority of my calls are incoming calls.

Of the 32 billed long distance calls made from our office from mid-June to mid-July, about 2/3 of them were calls made to our own (816) area, leaving 10 long distance (outside 816 area) calls a month. At $4.70/line per month, that means that each long distance call actually costs us $1.41 each more than the charges reflect!

I also pay an answering service to pickup our calls after office hours. They have several lines that are utilized only for receiving calls. Since they have to pay the "universal access" charge too, they have raised their charges to us accordingly, even though the lines are never used for outgoing long distance calls. I am seriously considering dropping the answering service as a way to cut down my expenses. An answering service (or a 24 hour number) to most businesses is considered revenue-producing. To primary care physicians, however, it is almost exclusively for the convenience of our patients and for us to be available in emergencies, and only rarely does it result in any direct revenue to us.

All this is occurring at a time when:
1. The federal government is beginning to set some of our fees and is increasing their interference with and control of our profession;
2. Increased litigation is increasing physician malpractice insurance rates from a minimum of 40% to over 150% in some instances (our 3 physician group rates recently increased from $12,000 to $22,000/year);
3. Drug companies, suffering under onerous (they say) and unreasonable government controls, have had to either abandon their manufacture of some drugs and vaccines (DPT vaccine, for instance) or increase their prices (from $3.00 to $50.00); and
4. A large percentage of responsible physicians have chosen, in response to an appeal by the AMA, to freeze their fees for a 12-month period, through February, 1985.

Sure, the telephone company surcharge is only a small percentage of our annual operating costs, but everything that has increased is only a small percentage of those costs, too. This surcharge will increase our phone line basic charge by 7.5%.

In the interest of time, a lot of calls that are returned by physicians are made from coin telephones. Three years ago, the cost of placing a local coin telephone call went up 100%.

I resent my communications budget and my tax money being used to subsidize the telephone companies. They have been in a very comfortable position for the past 50 years--let them now enter the real world of free enterprise and perhaps have to take a loss for awhile until they can increase their efficiency.

If the federal government continues to allow the "universal access charge", at least consider allowing the small business user to determine how many of the trunk lines should be designated to make long distance calls from and place this surcharge only on those lines, rather than have to pay the surcharge on all lines, regardless of the number of long distance calls made? The technology for this contingency is readily available now. If only certain lines had long distance capability, the access to these lines could be readily controlled within the small business itself, thereby adding the additional benefit of control of long distance charges by the small business telephone user.

Thank you,

Donald A. Potts, M.D
Family Medicine, Inc.
1515 W. Truman Road
Independence, Missouri
64050

Mr. **Wyden**. Dr. Potts.

Dr. **Potts**. I have been generally pleased, as I think a lot of small businesses have, with the changes in the telephone industry since the breakup of the telephone monopoly. It is a lot easier to purchase equipment now than it was for some time earlier.

Some costs are down because the telephone company does not get a penalty from the users for using other than Bell Telephone equipment. For 3 years, I had to pay a $5-a-month charge on each line of my three lines just because I did not use Bell Telephone's equipment and purchased my own.

That was with the blessing of the Government, by the way.

In 1975 I purchased a call forwarding device at a cost of $800, and this feature is now available through the Bell Phone Co. for a few cents a month.

What is nice is that even the phone company is getting friendlier, as Joan Rivers says, and they have decreased or eliminated some of the tactics that they had been using over the years and now have a much better image. They even sometimes will negotiate with you, which is a very nice term.

Specifically, the impact on my medical practice has been that technology has improved to the point that there is better availability and better communication for physicians, more devices available for utilizing phone lines, data transfer, electrocardiograms, et cetera.

The negative aspects of the changes have been primarily financial which is what brings us here.

When one makes a long-distance phone call, I fully understand that it may be handled by several different companies, and I have no objection for paying for my long-distance phone call with whatever it takes to get it through. I do object very strongly to subsidizing the Bell Companies if I elect to use a different telephone company for my long-distance calls.

Prior to the Bell System breakup, this particular charge would have been included as a basic service and the public would not have even been aware of the specifics of how their communication money was spent. Luckily, we are now a little more enlightened.

In my business, like my good colleague here, I have three telephone lines. Primarily I have that many so that in an emergency situation, someone would not have to wait long to contact my office. Like most of the people who have testified, the majority of my calls are incoming calls.

I made 32 long-distance calls from mid-June to mid-July, and about two-thirds of them were made to my own the 816 area code, leaving 10 long-distance calls a month outside the 816 area. At $4.70 per line per month—the so-called access fee—that means that each long-distance call I made actually cost me $1.40 more than what the charges showed.

I also pay an answering service to pick up calls after hours for the sake of my patients. They have several lines that are utilized only for receiving calls. That is the only use they have; but since they have to pay the universal access charge, too, they have increased their charges to us accordingly even though those lines are used only for incoming calls. They are set up so they cannot be used for outgoing calls. I am seriously considering dropping my answering service as a way to cut down my expenses, thus actually causing some effect on another small business in our area.

An answering service to most businesses is considered revenue producing. To primary care physicians, however, it is almost exclusively for the convenience of our patients and for our availability.

All this is occurring at a time when the Federal Government is beginning to set some of medicine's fees and is gradually but surely increasing their interference with and control of the profession of medicine.

Increased litigation is increasing physician malpractice insurance rates from 40 percent to over 150 percent in some instances. Our three-physician group rate recently, 2 weeks ago, increased from $12,000 to $22,000 a year.

Mr. WYDEN. Doctor, let me just interrupt you. I have a great interest in health care and I'm on the Health Committee, but I think that we have so much to cover on telephone rates.

Dr. POTTS. I was just pointing out that some of our costs were increasing at a time when the AMA has asked physicians to freeze their fees, and our costs are not being frozen by any means or even limited.

I resent my communications budget, and my tax money being used to subsidize telephone companies. They have been in a very comfortable position for 50 years, and now let them into the real world of free enterprise and perhaps have to take a loss for a while until they can increase their efficiency.

If the Federal Government continues to allow the universal access charge, at least consider allowing the small business user to determine how many of his trunk lines should be designated to make long-distance calls from, and collect the surcharge only on those lines, rather than having to pay the surcharge on all the lines.

The technology for this possibility is readily available; and if only certain lines had long-distance capabilities, certain lines, then the access could be controlled within the small business itself, adding an additional benefit to the small business user.

Mr. WYDEN. Is Mr. Timothy Hogan in the audience?

He is not.

Mr. Skelton, any questions?

Mr. **Skelton**. I do ask that various letters I have received from various small business people be entered in the record. They were not able to be here to testify as these folks, and they are from different parts of Missouri when I read their names, but I would hope that they would be part of the record.

I might also remind these folks that your prepared statement, because of previous order of the committee, will be entered in the record, and then your verbal comments will immediately follow that.

I defer my questions to you, sir.

Mr. **Wyden**. Mr. Dreier.

Mr. **Dreier**. Thank you very much, Mr. Chairman.

First of all, let me say that special thanks are due from every member of this committee because, as small businessmen and women, you obviously are making a sacrifice to be here to participate, so special thanks from us to you for that.

What I would like to ask is Mr. Hogan said that you have three different stores. Is there any variation at all—I do not know how they are spread apart—any variation at all in those charges which exist from store to store?

Mr. **Hogan**. I do not believe so.

Mr. **Dreier**. Are there any of the panelists with facilities—Mr. Youngworth, I do not remember if you have just one facility?

Mr. **Youngworth**. We have one office.

Mr. **Dreier**. One office?

Mr. **Youngworth**. Right, for incoming lines.

Mr. **Dreier**. I just wondered where any variation in rate might exist for one operation with more than one outlet if there is no one here with more than one.

Doctor.

Dr. **Protzman**. The only suggestion I had—and I talked to United Telephone, an employee of theirs—since I am being charged an access charge on three lines, and I am also connected to Tel-Central. They also are paying an access charge. Quite simply, if we make an outgoing long-distance call on either of our other two lines, if you use it, pay for it; but there is no point in paying it twice.

Mr. **Dreier**. This is a question again for every single one of you. What recommendations would you offer at this point as a way in which we could equitably and fairly address the problem of that constraint being imposed on the small business sector of our economy to foot this burden?

Mr. **Hogan**. I think the problem, when the chairman of the Missouri Public Service Commission cannot even get a handle on the cost, it seems to me like there is an awful lot of confusion with the breakup—that seems to be the standard patent answer to every question. Obviously, any tax ought to be equitable, or at least attempt to address it in an equitable fashion. This is not the case here. You are asking us for an answer to a solution or asking us to answer a question that the people whose responsibility it is do not even have any idea.

Mr. **Dreier**. But we are just trying to get as much input as we possibly can, as I am sure you can understand. I certainly agree that it is not being handled in as equitable fashion as it could, as you said I said in my opening statement. Singleline users and large businesses do not have that burden, and I just wondered if any of you have specific recommendations as to how we could make it a more equitable arrangement.

Mr. **Youngworth**. I do not really, like anybody else, have any solution. I just think, as you mentioned, one line for some reason for an access charge becomes a small business, and there is large business with multiple lines; and somehow we become large businesses in that sense, and I do not think you can make a determination that, well, one line is something; and if you have more than that, you are something else.

Mr. **Dreier**. You are right. There are a great many definitions for what a small business is. We see all of them in Washington, and I have never heard the definition of a shift from a small to a large business one to two lines.

Thank you very much, Mr. Chairman.

Ms. **Ruml**. Could I make one comment?

Our business is special. We have the same problem in our office as far as the three telephone lines, local lines; but when you talk about the kind of music service we have here, when you go to the tariff office like you go to the Missouri Public Service Commission, they have piles of tariffs that would make our telephone books look like pocket dictionaries; and to find one's rate is very difficult. And so to get into specialized areas such as ours where you are just transmitting a music signal or a voice signal or a wire signal—alarm companies have this same problem—then we get lost, and so they go across the board, they say, oh, this does not look like much of a line, and so they want to put a 700-percent increase. They figure there are not too many customers like us, so they are not going to hear a big squawk, and we find this when we try to find out what the phone company is proposing for the next rate increase, so we can see whether or not we can deal with it. No one at AT&T can answer the questions. We do not know what their next request is going to be; and by the time we hear, it may be too late to let them know that this is a problem for us. After our kind of line is installed, there are no switching or interconnections once it is in. It is a one-time installation for which we pay. The music goes through day and night, and it is not one where you have people switching in and signals going to different areas so it cannot be a large cost.

Mr. **Dreier**. So at least one of the solutions, then, you would say, is a degree of planning so that you have some idea of what is down the road?

Ms. **Ruml**. Yes, and finding out what their cost is. I mean that, again, is a problem, what is it costing them to run our music signal, and is it costing them 700 percent more to run it now than it did before. We cannot find that out and that is something I hope your committee can look into.

Mr. **Dreier**. We hope so, too. That is why we are here.

Ms. **Ruml**. We appreciate the chance to talk with you.

Mr. **Dreier**. Dr. Protzman.

Dr. **Protzman**. Could I ask Mr. Wyden why an access charge on single-line businesses would only be $2 and why it has been deferred until after the election?

Mr. **Wyden**. I think we want to do our questions before we take your questions.

Mr. **Dreier**. By the way, Mr. Wyden is not responsible for that decision, Dr. Protzman.

Mr. **Skelton**. The FCC did that, and we have the same question of them, as a matter of fact.

Mr. **Wyden**. I must tell you that that was sheer and raw politics——

Dr. **Protzman**. If a line is going to cost so much, it is going to cost so much whether you have three lines in your office or one line in your office.

Mr. **Wyden**. The House of Representatives at least passed a bill which attempted to allocate cost fairly, and clearly the politics of all of this has been very transparent——

Mr. **Dreier**. Please do not imply, however, Ron, that the House of Representatives never involves itself in sheer and raw politics.

Mr. **Wyden**. My colleague and friend knows that never once has happened in the history of——

Mr. **Skelton**. May I ask a nonpolitical question at this point of you, Ms. Ruml?

Ms. **Ruml**. Yes.

Mr. **Skelton**. Yours is a rather unique business, and yours is not the only one in the country such as this—I am sure they go by other names, but do you see this business of providing music to small businesses in the Nation as being threatened with extinction as a result of what is happening in the telephone industry?

Ms. **Ruml**. In areas where we have to use telephone lines, it certainly would threaten our ability to reach small businesses or other businesses with our service if we had to depend on a telephone line because the rates would be so extraordinarily—it is such an inflationary increase that it cannot be handled.

Mr. **Skelton**. What percentage of the businesses that you know of rely on telephone lines?

Ms. **Ruml**. In this area, we serve something like 12 to 15 percent of our customers by telephone line. They represent approximately 12 to 15 percent.

Mr. **Skelton**. Would this be true throughout the Nation?

Ms. **Ruml**. Our problem is that we serve on an FM side band generally. When you have hills or buildings obstructing things—I imagine downtown Chicago, for example, would have to go out on telephone lines.

Mr. **Skelton**. Try San Francisco.

Ms. **Ruml**. Yes, right, or any town where you have a congested downtown area, you cannot put FM signals through buildings so you are forced to serve those downtown areas where you have most small businesses clustered.

Mr. **Skelton**. Thank you.

Ms. **Ruml**. Thank you.

Mr. **Wyden**. Mr. Youngworth, let me start with you. You seem to be, as far as I can tell, representative of small business in this country. You make mostly local calls and have a small number of long-distance calls thrown in. As far as I can tell, you are going to pay more in access charges for the privilege of having the opportunity to make a long-distance call in this country, and you are going to pay for the actual cost of the long-distance calls you make, is that right?

Mr. YOUNGWORTH. I am not sure if it equaled out. I do know that if we have an average long-distance bill of about $90 a month, and you add $24 on that just for having four lines, it is a substantial percentage of increase.

Mr. WYDEN. How much is the bill for the long-distance calls you make now?

Mr. YOUNGWORTH. About $90 a month total.

Mr. WYDEN. So you will pay more, then, for your long-distance calls than you do for access?

Mr. YOUNGWORTH. Right. The bill was $90 and now it is $90 plus $24 if you wanted to add the access costs in there, or $114.

Mr. WYDEN. We are seeing a lot of businesses that are paying more for access than they are for the calls that they are making, but you are not one of them?

Mr. YOUNGWORTH. Not right on the average, no.

Mr. WYDEN. Good.

Ms. Ruml, a question for you.

You are talking about a 700-percent increase in your rates, as far as I can see?

Ms. RUML. This is the last proposal made but the FCC did not allow it. We do not know what their next request is going to be.

Mr. WYDEN. If there was a 700-percent increase or even, say, a 400- or 500-percent increase, you are saying maybe you could pass it on. It looks to me like you would lose customers.

Ms. RUML. We would have to terminate some customers because some of them wouldn't be paying that much as their monthly fee, so that we would just have to say: "I am sorry, unless you are willing to double what you are paying, we cannot serve you."

Mr. WYDEN. I think the only thing I would say in wrapping up this panel is that this strikes me, what I hear from all of you, as basically the repercussions of what the Federal Communications Commission has done. I call that supply-side telephone service, and the theory is: Give all the rate breaks to those who are very powerful and those who are very well-to-do and make mostly long-distance calls, and the theory is then maybe you can have a revenue base so that some of the benefits trickle down to everybody else. I must tell you I am not very enamored with that theory and, as you can hear from my colleagues on both sides of the aisle here, we are going to try to do something to get a better break for small business because, as far as I can tell, for those in the small business sector making mostly local calls and with a little long distance thrown in, there are not many benefits to the changes.

We thank you for your testimony and look forward to working with you.

Panel 3, William Sheppard, director of rate cases and regulatory affairs, AT&T, Kansas City; and Mr. Robert Jackson, MCI.

TESTIMONY OF WILLIAM P. SHEPPARD, DIRECTOR, RATE CASES AND REGULATORY AFFAIRS, AMERICAN TELEPHONE & TELEGRAPH COMMUNICATIONS

Mr. SHEPPARD. Mr. Chairman, thank you very much.

I am William Sheppard, director of rate cases and regulatory affairs for AT&T Communications, and I am located here in Kansas City.

I am appearing this morning in behalf of Ron LeMay who originally filed our testimony for this hearing and who has been unavoidably called out of town for regulatory matters in another State. I would like to adopt that testimony.

I am pleased to testify this morning in behalf of AT&T before these important hearings, and I would like to give a brief, oral summary of the testimony that was filed.

At the outset, I would like to respond to specific questions that we were given in the letter, the invitation of the task force. Those three questions, the first of which was, "What problems does AT&T face in providing long-distance service in rural areas?"

In response, I would say that if industry is allowed to move forward with cost-based pricing systems, we see no unmanageable problems in continuing high-quality service to the rural areas of this country.

Second, we were asked: "Do you expect long-distance rates for small businesses and other subscribers in rural areas to rise?" No, we do not see long-distance rates for small businesses or other subscribers in rural areas rising so steeply as to cause serious harm. In fact, if proper cost assignment and price adjustments are made, we expect to lower our long-distance rates accordingly.

Finally, we were asked: "Do we expect other interexchange carriers to compete aggressively in rural areas?" Yes, I expect other interexchange carriers to compete aggressively in virtually all of the markets where their investment will quickly pay off.

Under current tariffs, an interexchange carrier or long-distance company can establish a point of presence in any of the market areas, or LATA's, as they are called, to serve the metropolitan area, and they can serve the adjacent rural areas in that LATA at relatively small additional cost. Today there are 162 such LATA's in the United States, and 136 of these have at least one OCC competing with AT&T. Moreover, several OCC's have announced plans to establish a point of presence in every LATA in the country within the next 2 years. So, yes, we do believe this competition will spread across the country.

Regarding AT&T's policy, as the telecommunications industry becomes a more highly competitive environment—AT&T favors policies that are fair and equitable to all—we must find solutions that allow small telephone companies and small businesses to survive and flourish, solutions that meet all of the customers' needs. AT&T's policy is to provide quality service at reasonable prices to all of our customers. We will do all we can to enable the customers to adapt readily and enjoy the benefits of the changes resulting from competition and the introduction of new technology in our new industry structure. We are introducing new telecommunications services and new products to meet these customer needs.

I believe the critical need is to reprice services in the way that that procedure has been approached. In our judgment, there is one major factor that will affect the quality and delivery of telephone services throughout the Nation, and that is how telephone services are priced. If an economically sound and cost-based pricing system is introduced, we do not foresee any insurmountable problems in continuing high quality, reasonably priced service in all areas of the country.

If the pricing structure is not adjusted, however, we will face serious problems in meeting the needs of residential and business customers everywhere, especially in the high-cost areas.

The FCC's plan for repricing services by replacing a portion of existing subsidies from long distance with a small monthly customer line charge, we believe, is generally sound, fair, and balanced.

Traditionally, local rates have been kept lower than their cost by charging more for long distance. This system of internal subsidies could work when a single telephone company provided service without competition and the entire industry was, in effect, an integrated financial partnership. But in a competitive marketplace, this simply will not work. In fact, I believe it will be counterproductive.

In addition, bypass threatens to drain off substantial revenue necessary to continue maintenance and upgrading of the network, leaving behind underutilized facilities to be paid for by those customers who do not have readily available alternatives. As this happens, small business and lower volume residence customers will have to pay higher rates.

One answer frequently suggested for the bypass problem is to require the bypassers to support the local exchange network in some manner, but no one has yet outlined a feasible plan for identifying these bypassers or for collecting and distributing the revenue that would be involved.

The FCC plan would provide an overall approach for repricing telephone service, as I have said, we believe to be fair and equitable. Each business is required to pay a small monthly charge, the nationwide average being $4.89 for each telephone line that it uses. The maximum charge is set at $6. Small businesses and rural areas are treated equally and fairly under this plan.

AT&T believes that the approach taken by the FCC is a necessary and positive step toward a cost-based pricing system. In the interest of safeguarding customers who might be hurt by some unforeseen result of this plan, the FCC has taken several safeguards, one of which is to defer all customer line charges for residential and single-line businesses until next year and has renewed the study of possible impact on universal service and the need for further assistance for low-income persons and those in high cost areas.

The Commission is also examining alternatives to customer line charges, including suggestions by the Congressional Budget Office, the Joint Economic Committee, and others.

We believe the FCC plan will bring substantial benefits to customers everywhere.

First, monthly line charges will allow further reduction of prices for interstate long-distance calls. For many small businesses, these price reductions more than offset the increased monthly line charges.

Second, deterring uneconomic bypass by heavy toll users will prevent a spiral of increasing rates to remaining users.

Third, a cost-based pricing structure, with lower long-distance prices, will encourage more competition and innovation for all of the carriers involved.

Let me emphasize that there are no new revenues for AT&T or any of the long-distance companies as a result of these customer line charges. These charges are merely a portion of those formerly included in the long-distance bill and they go to the local telephone companies. Moreover, to the extent that even this small customer line charge may prove too burdensome for some low-income people, the FCC plan provides for a waiver on a targeted basis of these charges.

Concerning long-distance prices, the direct recovery by the local telephone companies of more of the fixed customer line charges or costs means lower charges for the long-distance rates. When customer-line charges for multiline businesses were introduced, for example, AT&T lowered its long-distance charges 6.1 percent for interstate toll calls for all customers, business and residence, regardless of their location.

An introduction of additional residential and single-line business charges in 1985 would make additional long-distance rate reductions possible, and there are long-range benefits, too.

Pricing closer to economic costs will yield substantial benefits in future years.

A recent study by Wharton Econometric Forecasting Associates found that the FCC plan would benefit both residential and long-distance users. Long-distance price reductions, Wharton found, will foster more vigorous competition in the long-distance market and strengthen the U.S. economy, strengthen it substantially, as a matter of fact. A Congressional Budget Office study released last June also found that the FCC plan would have benefits to the economy.

In conclusion, AT&T has worked steadfastly over the past 100 years to bring quality telephone service at reasonable rates to families and businesses everywhere in this Nation. Our commitment to high quality service at reasonable rates remains today. Major transformations have taken place in the industry, but we see no threat or universal threat, to small businesses, to customers in rural areas, or to low-income persons which the FCC plan would not prevent.

The only real threat is that, after much deliberation, deciding that competition is the best way to serve the people of the Nation, policymakers would falter in implementing such a decision.

Thank you.

Mr. WYDEN. Thank you.

[Mr. Sheppard's prepared statement follows:]

Prepared Statement of William P. Sheppard, Director, Rate Cases and Regulatory Affairs, American Telephone & Telegraph Communications

EXECUTIVE SUMMARY

There is one major factor that will affect the quality and delivery of telephone services throughout the nation, and that is how telephone services are priced. If an economically sound, cost-based pricing system is introduced, AT&T does not foresee any insurmountable problems in continuing high-quality, reasonably priced service to all areas of this country.

If the pricing structure is not adjusted, however, we will face serious problems in meeting the needs of residential and business customers everywhere, especially in high-cost areas.

The FCC's plan for repricing services by replacing a portion of the existing subsidies from long distance with a small monthly customer line charge is generally sound, fair and balanced. We believe that the FCC's plan will bring substantial benefits to customers everywhere.

First, monthly customer line charges will allow further reduction of prices for interstate long distance calls.

Second, pricing local and toll rates toward cost will deter uneconomic bypass by heavy toll users and will prevent a spiral of increasing rates to remaining users.

Thirdly, a cost-based pricing structure, with lower long-distance prices, will encourage more competition and innovative offerings.

In response to the Task Force's specific questions:

1.) If the industry is allowed to move forward with a cost-based pricing system, we see no unmanageable problems in continuing high-quality service to the rural areas of this country.

2.) We do not see long distance rates for small businesses and other subscribers in rural areas rising so steeply as to cause serious harm. If proper cost assignment and price adjustments are made, we expect long distance rates to come down accordingly.

3.) We expect other interexchange carriers to compete aggressively in virtually all markets where their investment will quickly pay off.While OCCs already compete in 136 of the 162 LATAs and several have announced plans to compete everywhere, AT&T remains the only universal interexchange carrier. We can continue providing quality service to high cost areas only if unfair subsidy burdens are removed and we are allowed to compete on an equal basis.

CHANGES IN THE TELECOMMUNICATIONS INDUSTRY: THE IMPACT ON SMALL BUSINESSES AND RURAL AREAS

My name is Ronald T. LeMay. I am Vice President - External Affairs for AT&T Communications in the Midwestern Region of the United States, which includes Arizona, Arkansas, Colorado, Idaho, Kansas, Oklahoma, Montana, New Mexico, Texas, Utah, Wyoming and, of course, Missouri.

I appreciate the opportunity to come before this Task Force to present AT&T's views on the important matters being addressed.

Members of Congress understandably are concerned about the numerous changes taking place in the telecommunications industry and want to better understand how these changes will affect their constituents, people in rural areas, small businesses and, indeed, customers throughout the nation. Some have been especially concerned that the FCC's planned implementation of customer line charges could impose an excessive burden on some local customers, particularly those in rural areas. Another concern is the growing tendency for large-business customers to bypass the local telephone exchange to avoid paying unfair and uneconomic subsidies. I will address those general concerns.

At the outset I will respond to the specific questions asked by the Task Force in the letter of invitation.

Question -

1.) What problems does AT&T face in providing long distance service in rural areas?

Answer -

If the industry is allowed to move forward with a cost-based pricing system, we see no unmanageable problems in continuing high-quality service to the rural areas of this country.

The threat to service in rural areas is the same as to all sectors of the market. The continuation of uneconomic pricing will cause high volume users to leave the network and will increase prices to those who cannot justify such alternatives and must remain on-the network. Until prices are restructured and all service providers are treated fairly and equitably, the marketplace, including rural areas, will not receive the full benefits of a competitive industry.

Question -

2.) Do we expect long distance rates for small businesses and other subscribers in rural areas to rise?

Answer -

We do not see long distance rates for small businesses or other subscribers in rural areas rising so steeply as to cause serious harm. If proper cost assignment and price adjustments are made, we expect to lower our long distance rates accordingly. On the other hand, if the pricing system is not restructured and the transition to full and fair competition is not begun there can be no assurance that long distance rates can be lowered.

Question -

3.) Do we expect other long distance carriers to compete aggressively in rural areas?

Answer -

AT&T expects other common carriers (OCC's) to compete aggressively in virtually all markets where their investments will quickly pay off. While rural areas may at first appear unlikely targets for competitive ventures, OCCs and resellers already are entering those markets. Under current tariffs, an interexchange carrier establishing a point of presence in a LATA to serve a metropolitan area can serve adjacent rural areas with little additional cost. Today 136 of the 162 LATAs already are served by at least one OCC. Moreover, OCCs have announced plans to establish a point of presence in every LATA in the country within the next two years.

Agribusinesses and other companies located in rural areas generate sufficient interexchange calling volumes to provide an attractive market for OCCs. These rural customers are not ignorant of the advantages of bypass. If this alternative is beyond the reach of a particular business or institution in a rural area, it may be well within reach if two or more join together.

Nevertheless, AT&T is the only universal interexchange carrier. AT&T is the only carrier that can originate and terminate calls anywhere in the United States. In some less heavily populated states, such as Vermont, AT&T is the only long distance carrier. AT&T's competitors have focused upon densely populated urban centers and heavy users.

AT&T is committed to universal service today, as historically; however, we can continue serving high cost-areas of the country, only if not saddled with unnecessary and unfair subsidy burdens. AT&T must be allowed to compete on an equal basis and earn at a rate that will keep the company financially healthy.

AT&T's Policy

As the telecommunications industry becomes more and more highly competitive, AT&T favors policies that are fair and equitable to all carriers and all customers. In seeking this fair, equitable and balanced approach, a solution must be found that allows small telephone companies and small businesses to continue to survive and flourish and meets the needs of all customers.

AT&T's policy now, as traditionally, is to provide quality service at reasonable prices. AT&T will do everything within reason so that customers are able to adapt readily to the changes resulting from competition, new technology and a new industry structure. AT&T is introducing new telecommunications services and products to meet customers' needs - some services and products tailored specifically to small businesses, others designed to improve services to rural areas. AT&T is also introducing new pricing options that allow customers a wider range of choices than in the past.

The Critical Need: To Reprice Services

There is one major factor that will affect the quality and delivery of telephone services throughout the nation -- urban areas as well as rural, large businesses and small, low-cost areas and high-cost areas. This key factor is how telephone services are priced. If an economically sound, cost-based pricing system is introduced, AT&T does not foresee any insurmountable problems in continuing high-quality, reasonably priced service to all customers in all areas of this country.

On the other hand, if the pricing structure is not adjusted to the demands of a competitive marketplace, the industry will face serious problems in meeting the needs of residential and business customers everywhere, especially customers in high-cost areas.

On balance, considering all interests, the FCC's plan for customer line charges generally provides an economically sound, fair and balanced approach for pricing telephone services.

By any measure, telephone service has been a bargain over the years, particularly when considered relative to other components of the Consumer Price Index or other business costs. Technological advances and increasing competition should enable us to provide continually improving services for customers throughout the nation. But in a competitive marketplace, such benefits derive from the economic efficiencies of cost-based pricing.

Traditionally, prices for telephone services in this country have been set not on the basis of the costs of the particular service involved but according to a cost allocation plan designed to shift increasingly larger proportions of the costs of the local customer connection to long distance services. Thus, local rates have been kept lower than their true costs by charging more for long distance. This system of internal subsidies could work when a single telephone company provided service without competition and the entire industry was, in effect, an integrated financial partnership. But circumstances have changed. The huge subsidies cannot continue to be sustained, and the uneconomic bypass which results from the customer's desire to avoid those subsidies will continue to increase as competition and technology drive down the cost of the alternative bypass systems.

In a competitive marketplace, a broad system that subsidizes nearly everyone simply will not work. Such a system is counterproductive. The solution is a reasonable balance. While low-income persons and those in truly high cost areas may need some level of support to assure that they will not have to forego telephone service, there certainly is no justification for subsidizing local telephone service for all customers -- or all small businesses, or all rural customers. The solution should focus on the truly needy through much more targetted programs and be phased in over a reasonable transition period before those business customers with heavy long distance usage set up alternative systems which bypass the local network entirely.

These so-called "bypass" systems threaten to drain off substantial revenue, revenue necessary for the continued maintenance and upgrading of the network. Bypass will leave behind under-utilized facilities, the cost of which must be recovered from those customers who do not have readily available alternatives. As this happens, small-business and lower volume residential customers will have to pay higher rates. The ultimate effect is that those customers who cannot afford an alternative system will suffer the most.

But, not all systems which would bypass the local exchange network can or should be stopped. There may be technical or economic justification for large businesses, government agencies or academic institutions to turn to private telecommunications systems, and it would not make sense for Congress or any other legislative body to attempt to hinder such technological development. The real danger lies in what is called uneconomic bypass -- a customer's selection of an alternative system solely because of uneconomic costs (subsidies) imposed on long distance carriers and their customers to support other services. Large customers are driven to build or lease bypass systems to avoid subsidy charges which they consider unfair. In a competitive environment, in which the customer has an alternative, such subsidies are economically unsustainable.

One answer frequently suggested to prevent uneconomic bypass is to require all bypassers to contribute to a fund or pool that would go to the support of the local exchange network. It is argued that all bypassers will need to rely on the local network as a backup for their own systems, so it is only fair that they continue to help maintain this network. On a very practical level, however, none of the proposals has outlined a feasible plan for either identifying bypassers or collecting and distributing the money involved. Further, such a tax would inhibit innovations and technological developments which are justified on an economic basis.

The FCC made a significant step in the repricing of telephone service with the decision to introduce a small fixed monthly charge on all customers, business and residential. This charge, which previously, and rather unfortunately, was called an "access charge," is intended to replace part of the subsidies from long distance to cover local loop costs. Accordingly, if the FCC plan were enacted and the subsidy burden removed over a reasonable transition period, long distance prices would be driven down to reflect true economic costs.

The FCC Plan

The FCC's overall approach for repricing telephone services is generally fair and equitable. Each business is required to pay a separate monthly charge to cover the costs of each its telephone lines. The charge which will be phased in over several years for residential customers varies by state, and when completely phased in will range from $2.85 to a maximum of $6.00. The average monthly charge after four years is $4.89. Small businesses are not singled out for any exceptional or unfair treatment -- neither are rural customers. The Commission has deferred all customer line charges on residential customers and businesses with a single line at a location.

AT&T believes that the approach taken by the FCC is a necessary and positive step toward a cost-based pricing system in which, so far as other factors allow, those responsible for creating costs will receive the bill for those costs.

The FCC has postponed fuller implementation of its plan until next year. The Commission has undertaken renewed studies of the plan's possible impact on universal service and the need for further targetted assistance to those who may not be able to pay new fixed monthly charges. The Commission also is examining proposed alternatives to customer line charges, including suggestions put forth by studies of the Congressional Budget Office and the Joint Economic Committee. The Commission recognizes the need to safeguard customers from sharp or unpredictable price changes during the transition to a new pricing system.

Others, including state public utility commissions, also are considering alternative ways of handling the necessary changes.

AT&T believes that the FCC's plan will bring substantial benefits to both large and small businesses in urban and rural areas of the country.

First, monthly customer line charges -- which in no case would exceed the true economic costs of that line -- will enable further reduction of prices for interstate long distance calls. For many small businesses, these lower prices will more than offset the monthly customer line charge. Small advertising agencies and consulting engineering firms, for example, are typically heavy long-distance users and they are already benefiting from recent reductions in interstate prices.

Second, deterring uneconomic bypass by heavy toll users will prevent a spiral of increasing rates to remaining users, including customers in rural areas and small businesses which do not have sufficient volume to justify setting up their own systems. Obviously, small businesses and rural telephone companies and their customers have much to lose from bypass but, in fact, customers everywhere will be hurt.

Thirdly, a cost-based pricing structure, with lower long-distance prices, will encourage more competition and innovative offerings by AT&T and other carriers. These, in turn, will stimulate usage that will result in lower unit costs and still lower rates. These lower rates will be reflected in lower prices throughout the economy, benefiting everyone.

There are no new revenues for exchange carriers or for AT&T as a result of customer line charges. These charges merely replace those formerly included in long distance bills, which had the major detrimental effect of inhibiting long distance calling. The charges are now more obvious and, although there is some redistribution among customers, the overall effect is beneficial. Moreover, to the extent that even this small customer li[illegible]arge may prove too burdensome for some low-income people, the FCC plan provides for a waiver, on a targeted basis, of these customer line charges. Further, the plan provides for support (subsidies) to be provided to high cost exchange carriers so that those serving rural customers can maintain reasonably priced services.

Lower Long-Distance Prices

Direct recovery by exchange carriers of more of the fixed customer line costs means lower charges to the interexchange carriers and lower rates for their customers. Customer-line charges for multi-line businesses introduced last May, for example, were accompanied by a 6.1% reduction in interstate toll rates to all customers, business and residential.

Businesses with a single line (about 39% of the small businesses responding in a recent survey by the National Federation of Independent Businesses) benefited from that reduction in interstate toll charges more than their fellow small businesses -- in some cases, their competitors -- because the monthly customer line charge they were to pay has been deferred. Customers with $80 per month or more in interstate toll charges per line have seen a sufficient reduction in their long distance bills to offset at least the $4.89 average customer line charge they pay. Introduction of residential and single-line business charges in 1985 would make further toll rate reductions possible, reduce this threshold still more, and make many small-business customers better off than they are today.

AT&T is offering pricing plans to meet the particular needs of various classes of customers, such as small, rural businesses which may not have sufficient calling volumes to warrant their subscribing to WATS. In West Virginia, California, Wisconsin and Texas, for example, AT&T has filed intrastate pricing plans designed to lower the prices for long distance service for small businesses. "Reach Out - Texas" was recently approved on an interim basis. "PRO-West Virginia," an optional plan which has been approved by the state commission, features a flat monthly charge of $10 for each main billed number at a location. With that, the customer receives a 15% discount on all directly dialed intrastate long distance charges. AT&T is considering similar plans in other jurisdictions. Such plans can help customers further offset the effects of a monthly customer line charge and enable them to use their telecommunications service to make their businesses more efficient and productive in other ways, as well.

Bypass

Economic bypass of the telephone network -- the establishment and use of alternative private systems because they are more economical or more efficient -- cannot and should not be discouraged. Uneconomic bypass, to which large customers turn to avoid the burden of subsidizing other services, is another matter. The relationship between economically priced telephone services and the threat of uneconomic bypass is direct and mutual. Economically sound, cost-based pricing discourages uneconomic bypass. Just as important, however, the growth of uneconomic bypass threatens economically priced telephone service, particularly in those parts of the country where costs already are high.

Moreover, the presence on the network of large-volume customers is a powerful incentive for carriers to innovate and invest in new technology. To the degree that significant telecommunications traffic leaves the network, this incentive is diminished, and the ability to finance improvements in service also is diminished. Also the introduction of more advanced technology, such as fiber optics, which may be justified only if calling volumes remain high, is discouraged.

Legislation passed by the House of Representatives last year, as well as that considered in the Senate, attempted to address the bypass problem by requiring at least some bypassers to make a contribution to the local network. But none of the plans put forth ever made clear how bypassers were to be identified or what sort of practical mechanism would be devised to collect and distribute the money.

In Docket 78-72, the FCC is making additional studies of bypass and has received data from many parties. It is already clear, however, that many large customers are moving to bypass and many more will do so if prices are not related more closely to costs.

Long Range Benefits

Pricing closer to economic costs will yield substantial benefits in future years.

A recent study by Wharton Econometric Forecasting Associates found that the FCC plan would benefit both residential and business users and, indeed, the entire national economy. Long-distance price reductions, Wharton found, will foster more vigorous competition in the long distance market and strengthen the U.S. economy over the next five years, leading to a $46 billion increase in the gross national product, 400,000 new jobs, a 1% reduction in the overall level of prices, and a $21.5 billion reduction in the federal debt. The FCC plan, the study said, would also have a favorable effect on the U.S. balance of international trade. The Wharton study recognizes that some means of subsidizing basic residential service to high-cost rural areas and low-income individuals may be required, but such subsidies would be limited and targeted.

The Congressional Budget Office, in a study released last June, also found that the FCC plan would have positive results. The plan would result in greater economic efficiency, the CBO report said, and would not greatly reduce telephone availability. Even the rather modest losses of service projected by most studies, the report said, are likely overstated. The report also found that increasing competition in the industry eventually could undermine any internal subsidy program.

Direct Costs to Small Businesses

As stated earlier, small businesses with only a single telephone line at a location (about 39% according to NFIB responses) now have no immediate customer line charges, but already benefit from interstate price reductions. Customers with two or three lines (a further 41% of respondents in the NFIB survey) pay an average of $4.89 per line. It is difficult to believe that a business that needs 2 or 3 telephone lines will be jeopardized by such a charge, particularly since the charge is offset partly, if not totally, by long distance rate reductions. If customer line charges for residential and single-line business customers are introduced in 1985, allowing further reductions in long distance rates, the break-even point will be even lower than it is today.

For businesses which make few or no long distance calls, customer line charges may result in an increase in their monthly bills. But, considered in relationship to other business costs, these additional charges are modest especially when compared to the benefits which could flow from the new cost-based pricing structure.

AT&T Services to Small Businesses

AT&T has a long-standing commitment to small business customers. AT&T's objective is to provide telecommunications services that will enable businesses to accomplish their goals and solve their problems. AT&T Account Executives try to assist small business customers in meeting those objectives. For example, telecommunications services are used for marketing, research, obtaining pricing information, servicing customer accounts, improving order processing and distribution, providing more economical sales and service, training, and disseminating product and promotional information. Financing applications include improved credit information, credit management and account collection. Telecommunications services also aid in purchasing, improved delivery schedules and contractual arrangements.

Telecommunications can improve practically every function of a business. Telecommunications expenses are not an overhead expense but a means to improve business performance, earn additional revenues, and save on other costs.

CONCLUSION

AT&T has worked, steadfastly, over the past 100 years to bring quality telephone service at reasonable prices to families and businesses everywhere in this nation. AT&T's commitment to high quality service at reasonable rates remains today. Major transformations have taken place in the telecommunications industry recently. However, the only threat to universal service -- to small businesses, to customers in rural areas, or to low-income persons -- is failure to implement the programs planned by the FCC. The only real threat to universal service is that, having decided after much deliberation that competition will best serve the people of this nation, policymakers should now falter in implementing that decision.

The need for economically priced service is the key. A continued subsidy burden on long-distance customers will encourage more and more of those consumers to seek alternatives. In the judgment of AT&T, the consequences of bypass are not only serious for residential and small-business customers throughout the nation but are especially detrimental to the interests of customers in rural areas.

Mr. **Wyden**. Mr. Jackson.

TESTIMONY OF ROBERT S. JACKSON, DIRECTOR, FEDERAL POLICY, MCI, INC.

Mr. **Jackson**. Thank you, Mr. Chairman, Congressman Skelton. I am glad to be here today.

I will summarize my testimony.

The committee asked me two questions that are very similar. What are the problems faced by MCI in competing with AT&T in rural areas? Will MCI be able to compete on a nationwide basis by 1986, and, if not, when?

The 1986 date, I take to mean that is the date that the Modified Final Judgment schedule of equal access is going to be largely implemented, in September of that year.

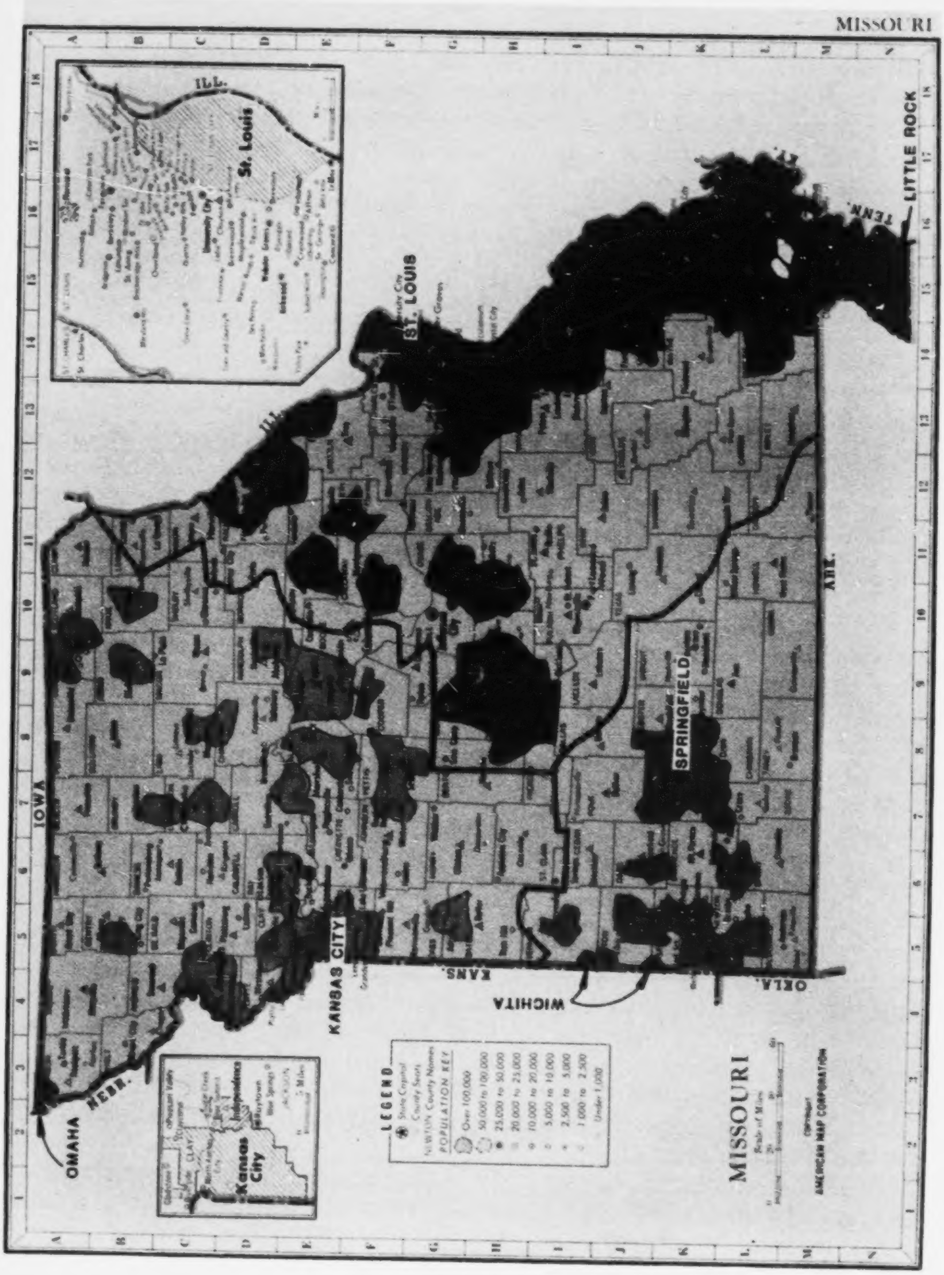
I want to take the second question first and just tell you what we are doing to compete with AT&T nationwide and, for that matter, worldwide.

I may be boring you to talk about "LATA's," and probably your telephone company has briefed you on it in your own State, but there are basically three in Missouri: the Kansas City LATA; St. Louis LATA; and the Springfield LATA.

Mr. **Skelton**. May we have a copy of that for the record?

Mr. **Jackson**. You certainly may.

[The map referred to above follows:]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OKLA.
ARK.
TENN.
LITTLE ROCK
LEGEND
POPULATION KEY
MISSOURI
AMERICAN MAP CORPORATION

Mr. **Skelton**. Fine. Thank you.

Mr. **Jackson**. There are 163 of these LATA's nationwide. Our intention by the end of the equal access cutover is to have a point of presence in all 163 of those nationwide. So the first thing that we have to do to compete with AT&T nationwide is to build a plant to all of those LATA's. That means we are going up to Boise and Montana and all those places that we never were supposed to serve, you remember. And we will spend this year approximately $1 billion on that effort. Our revenues last year were $1.6 billion. That gives you some idea of the scope of the investment we are making.

We are now in 81 of the LATA's, so that, over this 2½-year period we have got to try to go to the rest of the 163. It is a major, major construction job. That will give us a nationwide network. My colleague's network, AT&T's, is already in place so we've got to catch up.

We then have to obtain, as it comes along, equal interconnection facilities as these are offered to us by the Bell Operating Co. This means that our cost per line will jump essentially from the current $330 to about $800. This is going to occur neighborhood by neighborhood and not city by city, so that in Missouri our first cutover will be about 30,000 telephones in Springfield and in Kansas City on February 9, 1985, the first 35,000 telephones in the Kansas City area will be cut over.

We also have to obtain certification from the State public utilities commissions in order to offer intrastate service. This is very important because the theory of the consent decree rests here. It says that there will be a period of time in which the customer will be offered his choice of long distance carriers. Now he can preselect. He can say you, MCI, or you, AT&T, or you, GTE SPRINT, carry all my long-distance calls. So we have to be in a position to do it.

Currently we have intrastate applications pending in 21 States. We have gotten some type of authority in 16 so far. It is now pending in Missouri, which is why when I met the chairman of your commission this morning we just had to talk about the weather. We also have to negotiate operating agreements in the international areas with foreign governments and administrations so that we can carry long-distance traffic. And then we have to go get the customer. In many cases this means going out and building marketing operations from scratch.

We had none in Charleston, WV. We made it and we got intrastate certification. We got our terminals built, and we got the salesmen out there with national media attention. We are out there competing in the marketplace. In Charleston, WV, one of our salesmen spent an hour in a small business, sitting in a kitchen with the owner peeling shrimp. I must point out that he got the order.

Let me get to the second question, the rural service area question.

Competing with AT&T in the rural areas means that under the terms of the consent decree we will have Point of Presence in a LATA, and then we must expand our service area within the LATA.

Initially, we will probably have St. Louis, Kansas City, and Springfield. Later on we will probably add Joplin and it will grow. The local phone company then is obligated to carry our call to an end. * * * I am not going to say the word "end user," Mr. Wyden.

Mr. **Wyden**. We call them voters.

Mr. **Jackson**. We call them customers. And they do vote. To a voter out there, or if he is our customer and one of your voters also benefiting from competitive long-distance telephone service, then he will call in from anywhere in this LATA and we will get his call handed off to us by the phone company.

Now, look at the gray areas here on this map, which is appropriate for independent telephone companies. They have, except in a few cases, associated themselves with the LATA's, and that means that getting in and out of Missouri or in and out of the LATA's or between them, the scope of competitive service can expand very quickly, as my friend from AT&T said.

Now, the Judge left the question of intra-LATA competition to the State public utilities commission, and that is now pending. I do not think they have forbidden it. I think that that was a misstatement, that they have postponed the question for now, as most States have. But this means that when we have a Point of Presence in Joplin and Springfield, it may be to the consumer's benefit for us to build our own plant here rather than to depend on the telephone company's plant.

Intra-LATA competition is eventually going to occur, I believe, but that is one of the major issues as far as our competition within these local areas is concerned, and it is up in the air and it is before the public utilities commissions.

I am going to conclude my testimony at that point. I hope that it has been factual and helpful, and I will respond to any questions you have.

[Mr. Jackson's prepared statement follows:]

PREPARED STATEMENT OF ROBERT S. JACKSON, DIRECTOR, FEDERAL POLICY, MCI, INC.

I have been asked to address two specific questions today. They are:

-- What are the problems faced by MCI in competing with AT&T in rural areas?

-- Will MCI be able to compete on a nationwide basis by 1986? If not, when?

My reply begins with the general answer that MCI intends to compete with AT&T not only nationwide, but worldwide. And in the case of nationwide service, we are making an investment in communications plant that is remarkable in American business history.

A more specific answer must begin with the AT&T divestiture consent decree, or Modified Final Judgment, and its requirement that the Bell Operating Companies make equal interconnection arrangements available to AT&T's competitors, who are usually termed Other Common Carriers, or OCCs.

Another pertinent acronym is "LATA", which stands for Local Access and Transport Area, the phone companies' term for the geographic areas within which the BOCs may operate under the terms of the MFJ. There are 163 BOC LATAs nationwide, and many of them are huge. Within them, the BOCs offer local telephone service, and something in excess of $6 billion in long distance service, or half the intrastate toll business. These LATAs are not "local service areas", and it is not true that the divestiture left the BOCs with "only" local service. It left them with local service, intraLATA long distance, the provisioning of customer premise equipment, enormously profitable Yellow Pages advertising, and half of the frequencies for cellular radio telephone service in their operating areas.

The final term which gets used a lot in these discussions is "Point of Presence", or POP. Simply put, each long distance carrier may have one or more Points of Presence in a LATA. Under the MFJ, the BOC is required to take traffic from any customer in a LATA to the Point of Presence or vice versa, as the long distance carrier designates. For MCI, this means we can now expand our service far beyond the local calling areas to which we have been restricted.

Within the LATAs, the BOCs are obliged to provide the OCCs with interconnection equal to that provided to AT&T. They have developed schedules which appear to provide equal access to approximately 70 percent of the BOC telephones by September of 1986.

And, finally, as equal access is made available, neighborhood by neighborhood across the United States, each telephone subscriber is offered the choice of predesignating a long distance carrier to handle all his normally dialed long distance calls -- interstate, intrastate, interLATA, and international.

MCI intends to take full advantage of the opportunities provided by the MFJ, which presents us with a job to do which is probably unprecedented in its scope, complexity, cost, and speed of execution for a company of our size.

Going in, AT&T has its backbone interLATA network in place, its Points of Presence in place and often co-located with the exchange carrier, full interconnection with the BOCs, authority to operate on an intrastate interLATA basis, and a monopoly on almost all international voice traffic.

What MCI must do, to compete with this established competitor, is the following:

- Expand its network so that it will have a Point of Presence in each of the LATAs. Currently, MCI's terminals exist in 81 of the LATAs, and we will be building our network to the rest over the next several years. The construction job is enormous. MCI will invest approximately $1 billion in plant this fiscal year alone.
- Obtain equal interconnection facilities as they become available, neighborhood by neighborhood, across the United States. The first "equal access city", Charleston, West Virginia, saw 42% of its phones cut over on July 15, 1984, with national media attention to an unprecedented marketing effort by the contending long distance carriers. Equal access will begin to be available in the Missouri LATAs according to this schedule:

DATE	CITY	NUMBER OF MAIN STATIONS
1/26/85	Springfield/McDaniel	30,600
2/9/85	St. Louis/Evergreen	44,800
2/9/85	Kansas City/McGee	35,500

In the next two-and-a-half years, the pace will quicken, and by mid-1985 we will be adding more than 100 exchanges per week to the list nationally.

o Obtain certification from the State Public Utilities Commissions to operate as an intrastate carrier. Currently, MCI has authority to start intrastate operations in twenty-one states, and applications pending in sixteen others. In some cases, we must first attempt to change state statutes even to permit competition. This year, statutes have been rewritten in four states. In many of these proceedings, regulatory or legislative, we are routinely encountering resistance by incumbent telephone companies on many crucial issues and, in some cases, resistance by state commissions themselves to the concept of competition and lessened regulation of competitive carriers in accordance with established national policy.

Time after time, we are having the following experience: While AT&T is essentially "grandfathered" as an intrastate interLATA carrier, we must endure a protracted adversarial regulatory proceeding which has been resolved, and in some cases poorly resolved, not until the eleventh hour before the first equal access cutover occurs in a state, or before beginning a major advertising campaign in preparation for it.

In several instances, we are confronting an equal access date of September 1, and the states still have not acted on our tariffs.

In Missouri, MCI filed for certification to provide intrastate services on October 31, 1983. Hearings were held on August 6 and we expect a decision in late September of this year.

- Negotiate international operating agreements with foreign administrations so that we may offer our customers complete calling ability, thus enhancing our attractiveness as a presubscription carrier. To date, we have agreements for testing with Australia, Canada, and Belgium, with more expected soon.

- Go get the customers. The presubscription language of the MFJ affords a one-time opportunity to interexchange carriers to attract customers as they select their carrier for long distance services. The opportunity will never be so great again, and we are pushing to take advantage of it. This means a heavy commitment of advertising dollars, and, in many cases, the building of a local marketing organization from scratch.

All of this must be performed on a rigorous schedule, and we are doing it. The timetable established under the MFJ will give equal access to those who compete with AT&T in areas serving approximately seventy percent of BOC subscribers, by the 1986 date mentioned by the Committee in its second question.

The Committee's first question goes to the question of rural service. In this case, we must compete with both AT&T on an interLATA basis, and with the BOCs themselves, inside the LATAs.

One of the purposes enunciated by Judge Greene in approving the LATA plan was to bring the benefits of competition to larger and more remote areas. His order states, therefore, his expectation that the Public Utility Commissions would authorize competition within LATAs.

Unfortunately the telephone companies are resisting that, usually in the context of our certification proceedings or in the state legislatures. They are, in effect, attempting to monopolize something which common sense, the advance of technology, and the political consequences of trying to Balkanize the telecommunications market will not, in the end, let them keep.

At this juncture, let us simply compare the scorecard with Judge Greene's expectation. Nine states have approved some form of intraLATA competition. Only California, so far, has forbidden it. All others have deferred consideration of the issue to a later date.

The second situation -- vis-a-vis AT&T -- is more favorable at present. By FCC decision, the access charges paid by interexchange carriers cover LATAwide service. This means that MCI is now able to expand its current program of ordering circuits to reach new customers in smaller communities. Thus, our ability to reach the far corners of a LATA is constrained only by the economic fact of life that it takes time and money to accomplish it. It is, however, an equal access opportunity we intend to pursue as vigorously as any other.

Two weeks ago, the National Exchange Carrier Association petitioned the FCC to reduce the scope of access back to the local calling area -- for OCCs, but not for AT&T. The FCC denied the request pending submission of more information on the effects on customers and carriers. This request by the exchange carriers would be contrary to the spirit of the MFJ and we do not expect them to prevail. Should they, however, the result would be to blunt the kind of competitive choice this Committee is inquiring about. MCI, for instance, would have to cancel our plans to expand our network to more than 100 communities.

In summary, the action of the MFJ permits and encourages the competitive situation encompassed in the Committee's questions. It will be hard won, and it will remain incomplete for some years because of the enormous investment required and because of substantial misguided resistance. But if we can make it happen, we will.

This concludes my testimony.

Mr. **Wyden**. Mr. Skelton.

Mr. **Skelton**. I would like to ask, Mr. Sheppard, if I may, about the deaveraging. You heard my earlier comments and questions on that, did you not, sir?

Mr. **Sheppard**. Yes, I did.

Mr. **Skelton**. The REA estimates that deaveraging will raise toll call or toll rates two or three times over their current level. Why does it cost so much more to bring long-distance telephone service to rural areas?

First, let me ask you, do you agree with the REA estimate?

Mr. **Sheppard**. I do not know the basis of their figures, but you have to make a fundamental assumption about how access charges will be set by the FCC, or the State commissions if you are talking about intrastate, and apply it on AT&T or MCI.

In the case of AT&T, those fees that we pay to the local companies comprise over 70 percent of our total expense. If those fees are relatively uniform between all the companies, then there is very little pressure to deaverage to the various individual towns because the cost of reaching each of those towns is relatively the same.

On the other hand, if someone were to set access charges extremely high to go to one town and much lower to go to another town, we would have little choice but to reflect those access in the rates we charge for completing calls to those places. So to a large degree, the question of deaveraging is more in the hands of the regulatory bodies than it is in the case of AT&T because, in addition to those 70 percent of our expenses being set by an outside force, more than half of the remaining expense is not route specific. The depreciation and legal expense and that sort of thing does not have much to do with the individual town.

Mr. **Skelton**. Does AT&T have an official position regarding deaveraging, and, if so, do you favor it?

Mr. **Sheppard**. We have not taken any action at this point to deaverage. We will resist deaveraging and we will have to respond to the pressures in the marketplace, and so it kind of depends on what develops in the future.

Mr. **Skelton**. So AT&T's official position is that of being opposed to deaveraging, is that correct?

Mr. **Sheppard**. Yes. We think it would be much simpler to maintain a uniform price schedule and price that way, but we would have to be responsive to the cost pressures.

Mr. **Skelton**. Now, if I were to ask you the same questions, Mr. Jackson?

Mr. **Jackson**. A deaveraging question, where is Rich Hill?

Mr. **Sheppard**. Rich Hill is right down there near Butler, Bates County. It is about 50 miles south of here.

Mr. **Jackson**. The call from Rich Hill does not go to New York direct, it comes up here to Kansas City. So that the example you used of Chicago to New York versus Rich Hill to New York would be answered this way: There is that 56 miles or so to cover to get to the backbone network, and then it gets on a high capacity network to New York, and the technology averages out the cost and there should not be any difference, trivial difference, between the rates charged for one versus the other.

Deaveraging does not make a whole lot of economic sense, and I do not think it is going to occur.

Mr. **Skelton**. Are you saying that I am concerned over something that is not going to happen?

Mr. **Jackson**. Well, we may be dealing in semantics, and we may be talking about several different things.

Mr. **Skelton**. The end result is that Rich Hill, Versailles, Dover, and you name them, will be paying a lot more money if this comes to pass than our Kansas City friends?

Mr. **Jackson**. No. There is no reason for it. In the example that you set, there is no reason for it.

Mr. **Skelton**. Give me an example where it could cause a problem.

Mr. **Jackson**. When you are talking about a call from Rich Hill to another small community, say, less than 100 miles away and it is not going to New York, that is when you get into the short-haul toll rate question, and that is where you have to look at each State and find out how much those toll rates are, are they below cost, are they compensatory and so forth. But, in general, the kind of deaveraging, the way that it has always been presented for the last 5 years in these debates, is not economically sound.

Mr. **Sheppard**. Congressman Skelton, could I expand on that briefly?

Mr. **Skelton**. Please do.

Mr. **Sheppard**. It is approximately the same distance in the other direction, to St. Joseph, which is a bigger place. What our expenses are to go north or south are identical; and there is no pressure at the moment, the way access charges are structured, to charge different costs between a call to St. Joseph and Rich Hill. Now, if that were to change, then you would have to reflect that; but at the moment, those pressures are not there.

Mr. **Skelton**. Mr. Sheppard, what are your current one-party business and residence service rates?

Mr. **Sheppard**. I would defer that question to the Southwestern Bell witness. I do not have single-line business. I only have long-distance rates.

Mr. **Skelton**. Thank you. I will ask that later today.

Thank you very much.

Mr. **Wyden**. Thank you.

Just a few questions, Mr. Sheppard. I started with the last panel by characterizing the FCC approach as supply-side phone service, as basically giving all the rate breaks to those who are big and powerful and who make a lot of long distance calls. Do you agree with that analysis; or if you disagree, how so? I want to find out how small business people are going to benefit from some of these things that are going on.

Mr. **Sheppard**. I guess my principal difference with that characterization would be that what we are talking about is people paying for the expense that they cause the networks to incur. To me, and I do not know what the words would be, but it is unfair to cause some customers like McDonnell Douglas to pay a $1,000 a month subsidy to the local network for a line that did not cost them any more than a single-line business. It is a matter of balancing this out.

Mr. **Wyden**. I would not disagree with that. I think all of us understand we are trying to move toward cost-based pricing—that is the goal. But the question is how we get there and, again, what is in all this for the small business person. I see very clearly what is in it for the person who makes a lot of long-distance calls in the big business. What is in it for them is very clear. They are going to benefit from a competitive market. The long-distance area is competitive, but what is in it for the people on the previous panel here?

Mr. **Sheppard**. Of course, we end up talking about averages, and everybody is different and so the impact on an individual will vary from one type of business or another or one individual or another. But I think one of the things that is clearly in it is if we adopt a pricing policy that encourages everybody to stay on the public switch network and share in those costs, it is going to work out to everybody's benefit rather than creating the two-tiered or the three-tiered or multitiered communications network in this country where the really big businesses can afford and have already begun to put into place their own private network and you lose that support. So there is a question of how much support they would lose.

Another thing that Dr. Potts made a comment about that I thought went by relatively unnoticed—and I have not seen it commented on by anyone else—he was talking about the benefits that have come from competition in the customer equipment field, that he pays less now for his local telephone than he used to pay. That partially offsets this customer line charge.

Mr. **Wyden**. I heard a very different thing, that Dr. Potts does not pay less for his local service today.

Mr. **Sheppard**. Because he is buying his own instruments, and the way he gets his call forwarding and things like that, there have been changes on that side of the ledger that have clearly worked to the benefit of the residents and the small businesses.

Mr. **Wyden**. That does not have anything to do with FCC access charges.

Mr. **Sheppard**. The only reason I made that illustration is that is the result of a little more mature competitive environment than we have in the long-distance market.

Mr. **Wyden**. I still want to see if you can tell me something that benefits small business from the FCC access charge decision, and you said it will help to keep people on the network. I think that we will debate that in half a second, but the fact that Dr. Potts' local bill is not going down because of anything done by the FCC access charge decision, I just cannot see any benefits in this for small business, and I am anxious to have someone enlighten me.

Mr. **Sheppard**. The only other one that comes to mind immediately is they have already experienced a 6-percent reduction in long-distance rates.

Mr. **Wyden**. I guess that would be something; and most of them, as a result of the changes, have seen more than a 6-percent increase in their local rates based on what we have seen on the task force so that they have come out behind. But you talk about the 6-percent reduction in long-distance rates, and we have heard the Commissioner earlier today say that in the next 2 years the low figure for local rate hikes was going to be between 50 and 100 percent. So small businesses are coming out behind, and that is what we are concerned about.

Mr. **Sheppard**. I heard that, and I could not help but smile because I am preparing to go to Arkansas for a rate case where in the State of Arkansas local rates have gone up 20 cents since 1980. I think that figure is all over the map: But back to the other question, the 6.1-percent reduction was carefully balanced against this increase in access charges, so on the average it all comes out as a wash. The panel was not staffed with average people, I grant you that.

Mr. **Wyden**. I tell you, the people in my district consider themselves pretty representative of the people of this country. What they are saying is their long-distance bill goes down a little amount and their local bill goes way up and they come out in the hole, and I think therein lies the reason why all of us in the Congress are getting so much heat.

A couple of other questions for you, sir. There are some who say that this whole concern about universal service and how it is going to fare in today's changes is just alarmist's rhetoric, that there is no danger of our current situation with market penetration of 96 percent declining. Do you agree with that, do you think this is just alarmist's rhetoric, saying that universal service may no longer be with us?

Mr. **Sheppard**. I agree with most of the people that I have seen comment that there is not a tremendous elasticity but there is some; and to the extent there is some, I think it is a cause for legitimate concern, and I think that is why the FCC plan of direct subsidies to those people who have a particular problem and a high potential may be appropriate, the high cost factor for those local companies that are above the national average in their investment may be appropriate. I think there is a give and take that is going to have to take place over a period of time, but I do not think we can stay the way we are today because the high-volume users have choices.

Mr. **Wyden**. Nobody is debating whether or not to keep things the way they were.

Mr. **Sheppard**. OK.

Mr. **Wyden**. You favor direct subsidies; that is, things like phone stamps and that kind of thing?

Mr. **Sheppard**. It seems to me it is inappropriate to subsidize the millionaire the same as you do the person on food stamps.

Mr. **Wyden**. We agree with that, nobody wants to subsidize those people, but how do you do it? I have heard discussion of phone stamps, setting up a welfare system. Is that what you think we ought to do to make sure we do not subsidize the millionaire?

Mr. **Sheppard**. I think there needs to be a careful exploration of that. I have not given any personal consideration to that, but I think that several agencies of Government can work with FCC and develop a plan that can be administered. I think the big obstacle is how do you administer it.

Mr. **Wyden**. I do not think you can.

Mr. **Sheppard**. We have other programs we have administered.

Mr. **Wyden**. I think we have a difference of opinion on that. My background is working with the elderly. The whole history of working with the elderly program is that you cannot get these benefits to those who need them the most because they are too proud and they are independent as soon as you start talking about direct subsidies. I want you to understand that I know you are interested in seeing to it that the needy are taken care of, but I do not think it can be done. I do not think you can set up a welfare system, a two-cost telephone system, in this country and get the benefits to those who need it most. I am very interested in having somebody show me how to do it. But I must say, having had these hearings and having talked to people at AT&T, we always hear you should do it. Then when I say, "Well, show us how," and then we do not get anything back that strikes me as the way to do it. So we are very interested in the company's position on this, but we need some specific ways, if you all favor targetting the subsidies, of actually doing it. I have not seen any way to do it.

Mr. **Sheppard**. OK. I am sure you all will pass that along.

Mr. **Wyden**. Let me ask one other question and then I will turn it over to my colleague, Mr. Skelton.

Mr. Sheppard, my feeling is that the Congress of the United States, when we convene next year, is going to bar access charges. That is what we did in our bill that was passed in the House, and I just do not think that Chairman Dingell and Chairman Wirth are going to send the bill out to the floor of the House with residential access charges, and I have said that to your people and to others. One of the reasons we are holding this hearing and others around the country is to hear your thoughts on alternatives. I do not think we are going to have access charges, and I am wondering if you or the company have any other thoughts on how to allocate the costs. We want to do it fairly and we want to look at all the possibilities, and I do not think Congress is going to allow access charges to stand.

Mr. **Sheppard**. I recognize that that is a legitimate political concern, and I would point out that of the costs that we recover through our charges, only 30 percent of it is AT&T cost. All of the rest of it is going to the local telephone companies. So to the extent that they do not recover through local rates what the customer's costs generate, it has got to go someplace, so we do have a vital interest. I think the record is pretty replete with what we think the consequences will be, and that will be the multitiered, long-distance network that will develop in this nation because there are all kinds of alternatives out there.

Mr. **Wyden**. But we have always known that you all paid costs relating to traffic-sensitive costs.

Mr. **Sheppard**. But there has not always been all these alternatives.

Mr. **Wyden**. But what are you going to pay on nontraffic-sensitive costs?

Mr. **Sheppard**. We will pay what we are directed to pay. That is what we pay today.

Mr. **Wyden**. That is the issue, and, as I have said, the bill that passed the House attempted to cope with both the traffic-sensitive costs and the non-traffic-sensitive costs, and you all opposed the bill, and I cannot think of a better way to allocate the costs at this point than the bill that passed the House.

Mr. Sheppard. Let me quote you one brief figure, and this is not a plan. Today long-distance interstate calls represent less than 10 percent of the calls that are made, but it recovers 30 percent or more of the cost for an investment in the local loop, and that is the very fact that is driving people to seek alternatives because the high volume user is saying I do not want to pay for three times more than my usage, and some of them, it is 300 times more.

Mr. Wyden. We understand that the long-distance person has that concern, but, remember, every time you make a long-distance call in this country you go through a local loop at both ends. It was the judgment of the House of Representatives that some of those non-traffic-sensitive costs in conjunction with making the long-distance call had to be allocated to AT&T and MCI and others, and we do not have a better way of doing it.

Mr. Sheppard. Desirably, you should go through the local network, but I guess the point is not all of them currently go through the local network, and that potential is expanding. If Texas Instruments in Dallas wants to call Texas Instruments in Boston, they do not have to go through the local network.

Mr. Wyden. That, of course, gets us into the bypass issue. Again, the House is on record as saying bypass is a very real concern, there is no question about it. There is nobody in the Congress who wants to bar bypass and freeze our technology. But we, I think, dealt with the bypass issue in a constructive way by saying that bypassers, if they were in any way hooking into the local network, were going to have to pay something. On top of that, the Federal Communications Commission on its own has said that they are beginning to develop ways to insure that the bypassers are handled in a responsible way. So I come back to this proposition that we are looking for alternatives. I mean, we are anxious to hear other ways of doing it. I just think the brass ring next January is going to go to those who have some different ways to proceed because access charges are not going to happen. I mean, the House of Representatives, and I cannot speak for the Senate, is not going to enact those access charges.

One question for you, Mr. Jackson.

At what point does it become profitable for MCI to provide long-distance service in less populated areas? I can see that you are getting close to this at this point. When do you see that happening and what additional things have to happen to get you into the area and have the competitive juices begin to flow?

Mr. Jackson. You have asked a question that could be answered very, very technically by our economic people, but let me try to get you some sort of gauge. Before the LATA's were created, before we got into this mode of operation, we were beginning to add communities that were in the 10 to 15,000 category, and we are still adding big cities as we build to them; but what happens is our field sales people want their service area to correspond to the television signal footprint, and they want to get out in all of those communities. Each year they bring in their requests, and, of course, they want to do them all. We do as many as we can afford to get lines out to. In the current environment in the LATA's, we will add 100 new communities this year, and many of them will be small towns.

So that, I hope, gives you some sort of seat-of-the-pants grasp of where we are on our development in that way.

Mr. **Wyden**. It certainly makes it clear that it is at hand, and I do not think anyone disagrees with the benefits of having that kind of long-distance competition.

Mr. Skelton.

Mr. **Skelton**. The National Telephone Cooperative Association has set forth a position paper entitled "Position on Toll Rate Averaging," and it says:

> Issue. The next major problem likely to emerge from the introduction of competition into the telephone industry is a request by AT&T to discontinue its longstanding nationwide uniform toll rates commonly known as average rates.

That is deaveraging, is it not?

Mr. **Sheppard**. That would be deaveraging.

Mr. **Skelton**. Is that an incorrect statement or a correct statement?

Mr. **Sheppard**. I am not aware that we have proposed that.

Mr. **Skelton**. This is evidently before the FCC. I would like to know what the position of AT&T is on deaveraging. I thought I had an answer awhile ago. And this was just pointed out to me. If the National Telephone Cooperative Association is correct, what you said to me awhile ago is not correct.

Mr. **Sheppard**. I think I can clarify.

Mr. **Skelton**. Would you, please?

Mr. **Sheppard**. Not all of the telephone companies, particularly when you are talking about some of the smaller companies and REA type co-op operations, have the same amount of investment per customer they serve, and there have been three ways that have been considered to address that.

One would be for each company to establish their own access charges based upon their own rates. So they would have high access charges, and we would probably have to reflect that, and that might well drive us to deaveraging.

The second would be that access charges are pooled in large numbers of telephone companies which draw out of this pool, and that would sort of average out the effect.

The third is the FCC high cost plan, so that there would be a special fund for these telephone companies that have abnormally large investments per customer, and they would draw different levels of return from this high cost fund to offset this added investment that they have. To the extent that the high cost fund or the pooling of access charges tends to do away with the need to deaverage, I think it can be addressed. If everybody charges us what their costs are and their costs vary a lot, then there probably would be deaveraging.

Mr. **Skelton**. If you go to cost-based pricing, would that not really cause deaveraging?

Mr. **Sheppard**. Absent a pooling arrangement of some kind, it might, yes.

Mr. **Skelton**. Now, one rural area calling another rural area, Rich Hill, MO, calling a rural route at Cape Girardeau, MO, is that not going to cost more than Kansas City to St. Louis, which is roughly the same distance as the crow flies?

Mr. SHEPPARD. Today it costs slightly more because we have to pay a mileage fee to get the call out from Rich Hill to Kansas City, and we have to pay another mileage fee to get it from St. Louis down to the Boot Heel; but that amount is less than 5 percent of the total cost.

Mr. SKELTON. Do you have the potential of those calls varying in greater degree as time goes on?

Mr. SHEPPARD. That is more up to the control of the regulators than it is us. I am not really well equipped to answer that.

Mr. SKELTON. Do you have a comment on that?

Mr. JACKSON. The last part of it?

Mr. SKELTON. You looked like you wanted to say something.

Mr. JACKSON. No. I was just trying to follow what he is saying about what it is that regulators have pending on this.

Mr. SHEPPARD. How they would structure the access charges?

Mr. JACKSON. Yes. So if you deaverage the access charges, then you would have deaveraging. I see.

Mr. SHEPPARD. Or if they substantially raise local transport.

Mr. JACKSON. Yes.

Mr. SKELTON. Thank you, gentlemen.

Mr. WYDEN. One more thing. A couple more questions on this access charge area, Mr. Sheppard, and, again, we are just looking for some alternatives in this area, and it is based on my political judgment, not always right, but I think right in this area about what is going to happen.

What would happen to AT&T if access charges were just barred, we just flat out did not have them, what consequence would ensue if you all did not have that revenue?

Mr. SHEPPARD. We do not have that revenue. If you are talking about customer line charges, it goes to the local telephone company.

Mr. WYDEN. Yes. What happens to the system if we just do not have the access charges?

Mr. SHEPPARD. Somebody has to recover it, either the local telephone company through some other means, or it has to be subsidized out of the general tax revenue of the United States, or it has to be transferred to MCI and AT&T. There are options but the cost does not go away.

Mr. WYDEN. But what are the consequences of some of those options, for example? Let me ask about the option from your standpoint. What happens if you have to pay some of the nontraffic-sensitive costs, not the option the House is pursuing?

Mr. SHEPPARD. That takes us right back to the bypass discussion, we lose customers.

Mr. WYDEN. OK. That is what I wanted to get to. Demand is increasing today for telephone service, we know that. It is just part of the information age, no dispute, it is just happening, and it is a reality.

Now, a lot of this so-called bypass, and I just happen to think a lot of what is held as bypass, almost a bypass bugaboo, is not anywhere as pronounced as people say, but a lot of the so-called bypass is picking up some of the new demand. Are you not all going to grow no matter what, even with any kind of realistic appraisal of bypass?

Mr. **Sheppard**. No. I see that not necessarily in the consequences. As a matter of fact, I am not sure we grew last year. In the State of Missouri, we think we are going to flat suffer a drop in 1984, up to 10 percent of actual minutes' use of time.

Mr. **Wyden**. That just assumes, though, such a widespread incidence of bypass. It is pretty hard for me to understand how there is any realistic chance of it happening. For example, what we have heard, the largest bypasser in the State of Oregon, Tektronix Corp., does not even bypass for reasons of cost, which is what we are talking about. They bypass for reasons of service. And I just do not see how this notion that almost everybody with any money is going to go out and set up their own system and bypass the network has a chance to happen.

Mr. **Sheppard**. There are new technologies. I might add that we are not leading the pack in the development or the use of those. But the dish and the electronic message service, the low-power microwave, where you can put four dishes on top of the tallest bank building in the town and you can suck all of the long-distance calling in downtown Kansas City right out from under AT&T and Southwestern Bell, that is not a technology that is even in use, except in New York City, that I am aware of, but it is available. All you have to do is read the trade journals. There are four or five manufacturers advertising it every day. We do not even have a license to use that but there are a lot of people who do.

Mr. **Wyden**. But you all did not do too badly in the arrangements, you got Bell labs, your research arm, and Western Electric, the manufacturing arm, as well as the long-distance process. So I do not see how in the whole arrangement you are going to be locked out of the effort to keep up.

Mr. **Sheppard**. That is simple. Let me give you a number that locks us out of the arrangement. We charge 30 cents a minute for an interstate long-distance call today. If you put in your own system, you can switch it for a dime. That is what has the potential to lock us out.

Mr. **Wyden**. We know there are all kinds of areas where we are trying to move to cost-based pricing. No one has disputed that. But we just agreed that the demand is increasing. We also agreed that bypass is picking up some of the new demand. And then you said even with that, even with the increase in bypass picking up some of the new demand, your business, your profits, would not grow because bypass was so widespread, and I just think that is right at the heart of the dispute. I think it is inevitable that you are going to be—and that was part of the divestiture—in a position to have some very attractive financial arrangements in the years ahead, and I have no quarrel with that. I just want to make sure we do not drop everything we are doing in the system to deal with this bypass bugaboo. I think with bypass picking up only so much of the new demand, people like yourself are going to grow, and that is as it should be.

Mr. **Sheppard**. I think that is true, and I think a lot of your logic is correct, and, as a matter of fact, if there are some downward adjustments in long-distance prices, I think that has a strong stimulation. The elasticity for long distance is much greater than for local service; and if you lower price a little bit, you get this growth and it replaces the access revenue that was lost by the local companies because there are now more people making calls. We may grow, we may not grow, they may grow a lot, some people might put in bypass; but at lower rates, that will be less of a problem.

It is sort of a matter of do you want to stimulate long distance by adopting a price strategy that does that, or do you want to stifle it by leaving it where it is today.

Mr. **WYDEN**. That little scenario might be true if the consumer and these businesses could pay these access charges; but what we are hearing and what we are seeing—last weekend I went to a dedication of a community phone—is that people cannot pay them. That little scenario that you painted, I think, would have some validity if people could dig into their pockets and pay for costs to the local system that historically were being paid by AT&T, but I do not see any evidence that they can. That is what people are telling me, that is what we hear from the businesses, and that is what is at issue. So we have a lot of work to do. We are very anxious to work with your company and with MCI.

The House is not going to say that the access charge way is a principal way of allocating costs for the system. We are going to have to come up with some alternatives, and we will roll up our sleeves with you and look for them.

Mr. **SHEPPARD**. Thank you for the courtesy of inviting us this morning.

Mr. **JACKSON**. Thank you.

Mr. **WYDEN**. We are going to have a 10-minute recess and we will reconvene at 12:20.

[A short recess was taken.]

Mr. **WYDEN**. Let us reconvene.

Again, if you please, we will make a copy of your prepared remarks a part of the record.

Please, if you would, given our time constraints, just summarize, and both your comments and your prepared statements will go into the record.

Mr. McArton.

TESTIMONY OF ROBERT A. McARTON, GENERAL MANAGER, GRAND RIVER MUTUAL TELEPHONE CORP., ON BEHALF OF THE NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

Mr. **McARTON**. Thank you, Mr. Chairman; members of the committee.

I will summarize my testimony.

My name is Robert A. McArton. I am general manager of Grand River Mutual Telephone Corp. Today I also represent the National Telephone Cooperative Association.

Grand River Mutual serves 18,683 customers along 6,800 route miles of cable, which gives us an average of 3.6 customers per mile. Our service areas cover 44 exchanges located in 20 counties in northern Missouri and southern Iowa. As four of our exchanges make up 7,500 of our access lines, the other 40 serve the remaining 11,000, for an average of 278 customers per exchange. Twenty-one of our exchanges have toll-free calling in an area less than 1,000 access lines.

Our subscriber's average monthly phone bill is $35.23; $10.40 would be local. As you can see, we are a very rural telephone company.

I appreciate the opportunity to appear before the Small Business Committee's telephone task force. As a manager of a small telephone system in rural America, I can report to you that we need the support of Congress in order to continue to provide affordable telephone service in our rural areas.

The changes in the telephone industry today are especially burdensome to small rural telephone systems. All at once we are seeing an erosion of traditional sources of telephone revenues. We are finding it difficult, if not impossible, to project future revenues. We no longer are a monopoly but instead are operating in a competitive environment. We are trying desperately to remain a viable business while at the same time continuing to provide the high level of service with which we pride ourselves.

The bottom line is affordable customer service, but the real threat to rural telephone systems is total bypass, and that is the dropoff of customers from our system. There is distinct possibility of substantial subscriber dropoff given the access charge decision, divestiture, and the imminent threat of cost-based toll rates or toll-rate deaveraging.

As to FCC's access charge decision, NTCA supports the elimination of the end user access charge for residents and small businesses. NTCA supports the continuation of an interstate carrier's charge in a manner that is fair and reasonable for all. Since the interexchange carrier uses the local telephone company's facilities, it should contribute to those costs.

NTCA hopes that in its ongoing proceedings on access charges the FCC will increase assistance to rural systems from the universal service fund and adopt a method of calculating a company's cost that does not penalize those telephone companies which qualify for REA financing.

As for the effects of divestiture on small telephone companies, the time and expense has been staggering. We used to have two companies serving Missouri and Iowa, Northwestern Bell and Southwestern Bell. We now have 6 entities because we have Southwestern Bell in Missouri and Northwestern Bell in Iowa, the Southwest Division of AT&T in Missouri and the Midwest Division of AT&T in Iowa and the St. Louis division of NECA in Missouri and the Omaha division in Iowa. We have found that with our limited resources this paper chase has become very expensive.

What is coming down the road is the most worrisome thing to us. I can perceive that our customers—and, as I have stated, 40 of our exchanges average between 250 and 400 customers, and 80 percent of their long-distance calls, are within a 50-mile area of the towns that they live in. My fear is that they will end up paying the end user charge and because these are low volume, high cost intrastate routes, these toll calls will become higher. Therefore they will pay for the access and they will also pay a higher amount to make those calls which they have to make for most of their services in the rural areas.

[Mr. McArton's prepared statement follows:]

PREPARED STATEMENT OF ROBERT A. MCARTON, MANAGER, GRAND RIVER MUTUAL TELEPHONE CORP., ON BEHALF OF THE NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

I. INTRODUCTION

Good afternoon, Mr. Chairman and Members of the Committee. My name is Robert A. McArton and I am Manager of Grand River Mutual Telephone Corporation. Today I also represent the National Telephone Cooperative Association.

NTCA is a national trade association comprised of approximately 450 locally owned and operated small telephone systems providing service in rural areas in 42 states. Most of these systems have obtained capital financing under the loan programs of the Rural Electrification Administration (REA).

Grand River Mutual serves 18,683 subscribers along 6,819 route miles of cable, which is an average of 3.65 subscribers per mile. Our service areas covers 44 exchanges located in 20 counties in Nothern Missouri and Southern Iowa. We have a total investment in cables, buildings, and equipment after depreciation of $25 million, which amounts to $1,338 per subscriber. Grand River Mutual's average income from local service is $194,196 per month and $451,472 per month from toll. An average monthly phone bill is $35.23.

I appreciate the opportunity to appear before the Committee today. I applaud the efforts of the Task Force to preserve universal telephone service. As a Manager of a small telephone system in rural America, I can report to you that we need the support of Congress in order to continue to provide adequate, affordable, telephone service to rural areas.

II. CHANGES IN THE TELEPHONE INDUSTRY

The FCC's Access Charge Decision, the divestiture of AT&T and continued movement toward deregulation, taken in tandem, could threaten the existence of small, rural telephone systems like Grand River Mutual. Ironically, we are the ones responsible for the high level and quality of phone service in rural America today. We brought telephone service to the low density areas which others did not find profitable enough to serve.

The recent industry changes have resulted in a loss of traditional revenues and uncertainty about revenue recovery under a new system of allocating revenues, which is still evolving. Additionally, we are being asked to adapt almost overnight to a competitive environment. All of this leaves small, rural telephone systems with a very uncertain picture of their future. More importantly, it leaves rural telephone subscribers wondering whether they will be able to afford telephone service in the near future.

A. The Access Charge Decision

In an attempt to restructure long distance telephone rates the FCC established a system of access charges or flat monthly rates for access to interstate calling service, regardless of whether subscribers actually use the long distance network. The original end user access charge plan was approved by the FCC on December 22, 1982, in response to a competitive market place. Traditional common costs of the local telephone system which were recovered from long distance users were to be shifted solely to local users. The FCC responded to Congressional concern about the impact and fairness of end-user charges and delayed imposition of access charges on residential and single line business subscribers until June, 1985.

On May 25, 1984, multi-line business access charges of up to $6 per line per month went into effect. There is still much confusion about the implementation of the multi-line charge. Grand River Mutual small business customers with two lines in particular are outraged that they are suddenly being charged $12 per month for access to the long-distance network. Beginning in June, 1985 access charges to residential and single-line business will begin at $2, to be capped at $4 per month through 1990.

End-User Charges

NTCA supports the elimination of the end user access charge for residences and small businesses. NTCA supports the continuation of an interstate carriers' charge in manner that is fair and reasonable for all. It makes sense for interexchange carriers to be charged the access fee. It is the interexchange carrier which requires the use of the local telephone company's facilities, and should contribute to those costs. All users of the local telephone company plant, interexchange carriers and consumers, should contribute to the costs of the plant. The FCC access charge decision puts the entire burden on the consumers of the telephone company.

High Cost Assistance

As part of its Access Charge plan, the FCC established a Universal Service Fund to ensure that telephone rates in high cost areas would not rise unreasonably. It is critical that sufficient support be available to high cost companies from the Universal Service Fund. Rural customers should not be relegated to paying more for local telephone service or toll access than other Americans. Our concern was reflected in recovery levels in both S. 1660 and H.R. 4102 as passed by the House in 1983, which provided more support for rural telephone companies, than did the Commission plan.

We hope the FCC, in its ongoing review of the access charge scheme will increase the level of assistance to high cost systems from the Universal Service Fund to 100% of their non-traffic sensitive (or fixed) costs above 110% of the national average. Additionally, we believe the Universal Service Fund should be targeted to those companies who need it most - high cost companies with 100,000 access lines or fewer per state who serve rural areas.

Calculation of Company Costs

The FCC adopted the recommendations of the Federal/State Joint Board that the individual company's actual cost of debt be used in its cost calculations. This requirement penalizes those telephone systems that borrow from REA because it lowers their costs relative to those of non-REA borrowers. To prevent distortion and safeguard universal and affordable rural telephone service both the individual company's non-traffic sensitive costs and the national average used to identify which companies have comparatively high costs should use a nationwide average cost of capital.

B. Divestiture

In addition to the uncertainty about revenue allocation between the divested Bell Operating Companies (BOCs) and the local exchanges, the break-up of AT&T has created a tremendous workload for small telephone systems with limited resources.

Prior to January 1, 1984, the effective date of divestiture, all long-distance calling between the states was handled by AT&T. All calling within the state was handled by the Bell Systems in Missouri and Iowa. AT&T and the two Bell systems pooled these revenues and we received our share through agreements with them. In reality this arrangement was complicated but we were dealing with only two organizations, Southwestern Bell in Missouri and Northwestern Bell in Iowa.

After January 1, 1984, the breakup of AT&T caused a division which resulted in the following: all long distance calls between the states and between the area codes within the states are handled by AT&T. All calls within the area codes are handled by the two Bell companies.

AT&T and the Bell Companies are no longer allowed to pool long-distance revenues and AT&T no longer can be in the pool.

A national organization has been established known as the National Exchange Carriers Association (NECA), which functions as the pooling administrator for all long-distance revenues between the states. Each state has established its own method of division of long-distance revenues within the state.

As of January 1, 1984, we must deal with the NECA for revenues between the states, two pools established in Missouri for state revenues, Northwestern Bell in Iowa for calls within the area codes and AT&T for revenues between the area codes. We also have various of special agreements with AT&T, Southwestern Bell and Northwestern Bell for directory assistance, operator assistance, repair service and other needed services. As we operate in two states we must deal with the St. Louis office of NECA for Missouri and the Omaha office of NECA for Iowa. We also deal with the Southwest Division of AT&T for Missouri and the Midwest Division of AT&T for Iowa.

The quantity of paperwork in the form of data requests, revenue, and cost information, and reports has increased ten-fold. The cost of deregulation in the form of manpower and expenses has been staggering for Grand River.

C. Toll Rate Averaging

A critical factor in determining what rural rates will look like under deregulation is the future of toll rate averaging. Currently, all low-density toll routes, such as those in rural areas, benefit from toll rate averaging, which is a pricing concept whereby a customer pays equally for interstate calls across equal distances at the same time of day and same duration of the call. However, it is not clear whether the FCC will continue this policy. In its current consideration of long-range regulation of AT&T (Docket 83-1147), comments by AT&T indicate that it may seek permission to deaverage toll rates, in other words, to move toward cost-based toll rates. Deaveraging would spell disaster for rural telephony.

An REA study of Local Service Rates and Toll Bills for Subscribers in Rural Areas shows that the rural toll link into the interstate network costs many times more than equivalent urban toll routes. These costs were considered part of the traffic sensitive elements in the FCC access charge decision and charged to interexchange carriers. These higher costs should be included in the nationwide toll support mechanism or in some pooling arrangement. Otherwise their higher costs may discourage alternative interexchange carriers from serving rural areas or will encourage toll rate deaveraging in service from high cost to high cost areas

Grand River Mutual is currently studying the impact of toll rate deaveraging in light of the imposition of end-user access charges. This study, which we will be happy to submit upon its completion, is based on our best estimates of toll rates, projecting from past toll usage. Our findings at this stage clearly show that under deaveraging our local and long-distance rates would be so great that subscribers would be forced to drop telephone service altogether. First, we are finding that under deaveraging, interstate calls in our service area would increase by as much as a third, even with the 6% reduction in interstate calls recently approved by the Commission. Unfortunately, that is not the worst news for our customers. Eighty percent of our subscribers' long-distance calls are intrastate calls which are not affected by the 6% reduction. Yet, toll rate deaveraging will impact on interstate and intrastate calling. Since rural users throughout the country have local calling areas with fewer telephones to reach than urban users they are more dependent on intrastate long-distance service to reach such essential services as doctors, hospitals, schools, and the like. Drastically increased toll bills will isolate rural subscribers from these essential services.

In addition, all telephone subscribers will be subject to end-user access charges by June, 1985. The combined charges will simply be too much for rural customers to bear. We therefore anticipate substantial subscriber drop-off under the aforesaid circumstances. We urge the FCC and the Congress if necessary, to take an approach to toll rate averaging that would prevent the one serious bypass threat that we are aware of - that of subscribers dropping off the telephone network.

D. REA Financing Problems

During this period of uncertainty and upheaval in the telephone industry, the continued funding of the Rural Electrification Administration (REA), which has been the sole source of affordable financing for rural telephone systems, is a critical element in maintaining the rural telephone network. This is not the time to cut back on funding for the REA program or to jeopardize its future. Yet REA is in financial trouble and legislation which would ensure REA solvency and also enable REA borrowers to begin to rely on non-government financing is stalled in the Senate. Without REA assistance, many telephone systems will be unable to repair or upgrade their systems and thereby provide the service that rural subscribers require and deserve.

III. CONCLUSION

The combined effects of these changes in the telephone industry seriously threaten the availability of telephone service in rural America. But let us not forget that adequate telephone service to rural areas is not only a local or regional concern. For, agriculture is a linchpin of our economy as well as our foreign trade. Rural telephone service is essential for agriculture and other rural industries and it must be maintained. Higher costs for telephone service could be detrimental to all users of the network, but it could be disastrous to our rural agricultural economy.

Mr. WYDEN. Mr. Fisher.

TESTIMONY OF HOWARD N. FISHER, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER, CITIZENS TELEPHONE CO.

Mr. FISHER. Mr. Chairman, you have my prepared statement, and I am not going to go over those again.

I would like to reiterate the fact that paperwork is one of the biggest problems caused us just by the fact that we are dealing with a number of entities that we were not dealing with before.

Mr. WYDEN. Yesterday we heard about the pollution of information and paper.

Mr. FISHER. Bypass is a concern of the small telephone companies from the standpoint that if I even lose one of my business customers it hurts. Bell has a lot of them and I know it hurts them, and it hurts us worse.

Another thing that concerns us is universal service. We have always been concerned about it because I look every one of my customers in the eye from time to time, and they are interested in universal service. They have always wanted it and they want it now.

I think a lot of my customers are interested in the quality of their service. They want good service and they want dependable service, and they want that service like they have always had it before, and I take that as a compliment that they say that to me, that they want to continue to have good service.

Another thing that I am personally concerned about is the network as a whole. I see that in time it is going to deteriorate if too much money is taken away from it, and I think it is too good a national asset simply to see it deteriorate in that way.

That pretty much concludes the remarks that I have to make, Mr. Chairman, and I thank you and I thank Congressman Skelton for this opportunity.

Mr. WYDEN. Thank you.

[Mr. Fisher's prepared statement follows:]

PREPARED STATEMENT OF HOWARD N. FISHER, EXECUTIVE VICE PRESIDENT AND GENERAL MANAGER, CITIZENS TELEPHONE CO.

I am presently the Executive Vice-President and General Manager of Citizens Telephone Company in Higginsville, Missouri. Before my present position, I was Plant Engineer, Plant Superintendent, and Assistant Manager. I have been with Citizens Telephone Company for thirty years. Previous to that I was with another Independent Telephone Company for more than ten years, including time with the United States Army Air Force during World War II. Citizens is a relatively small company and I know many of our customers personally. I feel that I know their concerns to some extent and also know the problems that the telephone business faces. Our exchange area is predominately rural, agriculture oriented, and low density in population.

I feel that the communications industry must undergo a great deal of change in the next few years. I think that federal and state regulation contained the pressure of an expanding technology for possibly too long and that now change will happen with bewildering speed. One example of this is the unrealistically low depreciation rates forced on the telecommunications business for many years. I think that these changes will ultimately be beneficial for most of us.

All of our business customers are of the small business type. Anything that makes our service more inefficient will affect them also. In addition they are now faced with a six dollar access charge for multi-line customers which I feel is unfair because it is discriminatory. Many of our business customers have expressed concern about the reliability of phone service in the new enviornment. Citizens has always prided itself in the service it rendered. I suppose that it is a compliment when our customers ask "Can I still have the same kind of service?"

Both deregulation of the industry and the divestiture of the Bell companies have affected Citizens. We have approximately three thousand two hundred fifty access lines in our system and about five thousand two hundred telephones. The difference in these two numbers is mostly extension telephones from which we get slightly more than one dollar a month each in rental revenue. During 1983 we lost seventy five of these telephones because customers bought, or were given their own. The revenue loss was approximately eighty five dollars per month. In an industry query recently about the cost of these changes we were able to document very nearly fifty thousand dollars of added expense to Citizens caused by divestiture and deregulation in 1983.

Service has been affected by deregulation and divestiture. The simple fact that we Small Independent Telephone Companies are in all cases now dealing with at least five entities* where we previously only delt with one Bell company has caused a vast increase in paper transfer. A great many of our business transactions were previously done with the Bell company and are now done with both Bell and AT&T. Bell and AT&T personnel have done a fine job of accommodating to change. There have still been many instances when no one honestly knew where responsibility lay. Added work load has been experienced at most levels in our business, most especially in the accounting and commercial areas. These and other things have caused service problems that we regret but cannot avoid.

It is my belief that bypass is a more serious threat to small companies, such as Citizens, than the larger ones. My reasoning is thus: a small company often has only one or two relatively large toll customers. To lose even one of those customers to bypass is much more damaging than to a large company which has many such customers. Possibly even more of a threat is loss of revenue to the entire system. We small, high cost companies have depended on the entire system for a substantial portion of our revenue in the form of settlements. If revenue is diverted from the system to bypass, then we who have already been subsidized will probably be first to notice the loss. Resale constitutes a direct threat whether it is in the form of resale of exchange service or of toll. In either the reseller will only look for the most valuable customers, leaving to the telephone company the customer with the least profit potential to help support the cost of the network.

It is my belief that there must be a good "Universal Service" pool at the federal level. I think that the various State Public Service Commissions should administer this pool within federal guidelines. I believe that all entities that offer long distance or long distance like services should contribute to this pool. I also believe that all companies that offer any type of local service for resale should pay an access charge into the universal service pool. I do not believe a residence access charge should exceed four dollars per month. I believe that there also needs to be some kind of "lifeline" service, but that qualification for this service should be in the hands of a state social agency.

I appreciate this opportunity to share some of our experiences and concerns with the Small Business Committee.

Sincerely,

Howard N. Fisher

Howard N. Fisher
General Manager

* AT&T
Southwestern Bell
National Exchange Carriers Association
Missouri InterLATA Pool
Missouri IntraLATA Pool

Mr. **Wyden**. Mr. Caldwell.

TESTIMONY OF ROYCE S. CALDWELL, ASSISTANT VICE PRESIDENT, COMPTROLLERS AND EXTERNAL AFFAIRS, SOUTHWESTERN BELL TELEPHONE CO.

Mr. **Caldwell**. I am here on behalf of Southwestern Bell Telephone Co.

I am responsible in the State of Missouri for regulatory matters. I am comptroller for the State of Missouri, along with some other duties.

I would like, first of all, to tell the task force that the preservation of universal service is a concern which my company shares with this task force. The provision of high quality telephone service at affordable prices is our fundamental business and we are totally committed to that business. We support the implementation of the FCC's access charge plan. It is the best way to enable my company to continue to provide universal service over the long term.

The important fact about our network is that our physical facilities are either dedicated to the use of an individual customer or common to a group of customers. The dedicated facilities results in a fixed monthly cost regardless of the number of calls that a customer makes. All of these costs are referred to in our industry as nontraffic-sensitive costs. They are not affected by usage, in other words. Facilities are dedicated to an individual customer. The more calls that a customer makes, the costs are not increased.

The other type of costs that we have are called the traffic-sensitive costs, and these are facilities that are not dedicated to an individual customer and are affected by usage, so that the more calls a customer makes the more those costs increase.

Now, one other basic background fact that the committee needs to have knowledge of is that telephone companies have a dual regulation. A part of our costs for services are assigned to the State jurisdiction for regulation, while the remaining costs are assigned to the interstate jurisdiction and are regulated by the FCC. There are all kinds of ways through the years that these costs have been assigned to the FCC, but each and every one of them to a greater extent than the last one assign more and more of these nontraffic-sensitive costs to the FCC to be recovered in interstate toll rates.

Historically then, if you look at our pricing through the years, a large portion of the nontraffic-sensitive costs of the telephone network have been recovered through toll pricing, and this worked fine in a monopoly environment. Now with a competitive environment, our customers who are paying this contribution back to support the nontraffic-sensitive costs that are dedicated to the customer have alternatives, and that is why we must move to a more cost-based pricing system.

The combination of monopoly pricing and exploding competition creates the real and present danger of bypass, and I would like to say here that, in my opinion, bypass is a word that simply means that today's customers now have alternatives or options. It is a buzz word that is going around in our industry, but it just simply means alternatives or options for customers.

When large volume customers leave our network to avoid paying these subsidies, then we lose the contribution that they have been making to support the network. Furthermore, and I think this is an important point, not only do we lose the contribution but there is an investment that is stranded and left behind for the remainder of the people who are on the network to pay for. The more customers that drop off, the more costs there are left for others to pay, and so a vicious cycle has set in.

The FCC has implemented a plan that includes a customer line charge to be paid by all customers in order to recover at least part of the nontraffic-sensitive costs which result from that customer. This customer line charge has nothing to do with how much an individual customer uses interstate toll services. Customers do not pay this charge for the privilege of accessing the interstate toll network. Some have incorrectly defined it in that way.

The bottom line effect of the jurisdictional separation procedure and the pricing of nontraffic-sensitive facilities in a usage-sensitive manner was that frequent toll users through their toll prices contributed to the cost of these facilities dedicated to the exclusive use of other customers. High volume toll users pay many times the cost of their local exchange access line used to serve that customer.

A relatively small number of our customers account for a very large percentage of our revenue. In Missouri only 25 percent of our business customers account for 88 percent of our business toll revenues.

In our last divestiture rate case that was concluded before the end of last year, introduced into evidence in our rate case was a survey by Touche Ross & Co. which showed that 21 percent of our largest customers in Missouri are already engaged in forms of bypass.

The FCC plan is not designed to give the local telephone companies additional revenue as a result of these customer line charges. It is expected that interstate toll carriers will receive a decrease in the cost they must pay for the use of the local network. The FCC expects this reduction to be passed on to toll users.

The decision was made by regulators, legislators, and the courts to open up telecommunications to competition. Customers are benefiting from this competition. The industry is moving toward a cost-based pricing method that is absolutely necessary for the long-term viability of the local telephone companies and is absolutely necessary for the preservation of universal service.

Thank you.

Mr. Wyden. Thank you, Mr. Caldwell.

[Mr. Caldwell's prepared statement follows:]

PREPARED STATEMENT OF ROYCE S. CALDWELL, ASSISTANT VICE PRESIDENT, COMPTROLLERS AND EXTERNAL AFFAIRS, SOUTHWESTERN BELL TELEPHONE CO.

Mr. Chairman and members of the task force, I am Royce S. Caldwell, assistant vice president-comptrollers and external affairs of Southwestern Bell Telephone Company in Missouri. Besides other duties, I am responsible for company policy decisions and the ongoing administration of such policies regarding regulation and legislative matters in Missouri. My office is in St. Louis, Missouri. I appreciate the opportunity to appear before this task force to discuss the changes which are occurring in the Telecommunications Industry.

Before I get too far along in my comments, I need to make two basic points very clear. First, the preservation of universal telephone service is a concern which my company shares with this task force. The provision of high quality telephone service at affordable prices is our fundamental business, and we are totally committed to that business. The second point is that we support the implementation of the F.C.C's access charge plan as the best way to enable my company to continue to provide universal service over the long term. This support stems from the fact that there is competition in the provision of toll services. This competition will result in prices moving to the actual costs of providing service.

In order to appreciate the changes that are occurring in our industry, some background is needed concerning the costs and resulting pricing of our services in the past and how that pricing must be changed as a result of the introduction of competition in the telecommunications industry. Throughout my testimony, I will be greatly simplifying the detailed facts, and concentrating on overall policy considerations. The first fact one needs to understand about our network is that all our physical facilities are either dedicated to the use of an individual customer or are common to a group of customers.

The dedicated facilities result in a fixed monthly cost regardless of whether the customer makes no calls or one thousand calls. These facilities include what is known in the telephone industry as the local loop or local access line which is simply the wire between each customer's home or place of business and the local telephone central office. All of the costs associated with these facilities are referred to as non-traffic sensitive (NTS) costs.

The facilities which are not dedicated to an individual customer include, for example, the local and toll switching equipment. The costs for these facilities are directly affected by customer usage. The more calls a customer makes the more expenses or costs the company incurs. The costs associated with these facilities are commonly referred to as traffic sensitive (TS) costs.

One additional preliminary topic must be understood before we can adequately discuss changes in the industry, and that is the issue of jurisdictional separation. Telephone companies have dual regulation. A part of the costs of our services are assigned to the state jurisdiction and are subject to regulation by the State Public Service Commission, while the remaining costs are assigned to the interstate jurisdiction and are regulated by the F.C.C.. Under this system, the state regulatory bodies are responsible for regulating local exchange and intrastate toll services while the F.C.C. regulates interstate services.

In order to separate the costs of the telephone network between the state and federal jurisdictions, various methods and procedures have been used over the years. While the assignment of traffic sensitive costs is relatively straight forward, the assignment of non-traffic sensitive costs has been a controversial and sensitive issue. As the methods and procedures of making these assignments changed over the years, one constant theme was that an ever greater portion of the non-traffic sensitive costs were assigned to the interstate jurisdiction to be regulated by the F.C.C. and, in the past, to be recovered in interstate toll charges.

Under the existing formula, a nation-wide average of 26% of the total non-traffic sensitive costs are assigned to the interstate jurisdiction to be recovered in prices for services regulated by the F.C.C., and the remainder is recovered by services regulated by state commissions.

Keeping these facts in mind, we now need to review how telephone service has been priced over the decades. Regulators, both state and federal, have historically recovered a large portion of the costs of non-traffic sensitive plant - the plant I described as dedicated to individual customers and which are insensitive to usage - through usage sensitive prices. By this I mean regulators saw to it that large parts of these fixed costs were paid for through the usage sensitive charges for both state and interstate toll calls. Over the years, a larger and larger portion of these non-traffic sensitive costs were paid for by toll users in their toll rates. The effect of this effort was to create a subsidy which reduced the price customers paid for their local exchange loop or local access line. In other words, this subsidy kept the price for basic local service far below the true costs of providing that service.

I should interject at this time that the local telephone companies did not object to this cost assignment method and the resultant subsidy. In fact, for the most part, the telephone industry encouraged this arrangement. But, the task force should remember that the company and its regulators made these decisions when our industry was a regulated monopoly. In this pure monopoly environment, this subsidy system was workable and helped to achieve certain social and political goals. That pure monopoly environment does not exist today.

The end result of this pricing method was that frequent toll users, through their toll prices, contributed to the costs of those facilities dedicated to the exclusive use of other customers. For example, a business that makes 1,000 minutes of interstate toll calls in a month is, even today, paying about $105, if he uses ATT-long distance services, toward the costs of non-traffic sensitive plant or about five times the cost of the local exchange loop (local exchange access line) used to serve that customer.

For years, high volume toll users like this had no choice because of the regulated pure monopoly environment. If they wanted toll service, they paid the established price. Today, as we all know, the telecommunications world has changed dramatically. The Justice Department, Federal

Regulators, the Courts and certain legislatures have determined that it is now in the public interest for most telecommunications services to be open to competitors. Today, competition gives long distance users a growing selection of options. In this new competitive environment, there is no way to prevent managers of business from exercising their right to make economic decisions based on what is in the best interest of their business. These managers may be responsible for multimillion dollar corporations or a small manufacturing plant which is a heavy user of toll services.

The bottom line effect of the separation procedure and the pricing of non-traffic sensitive facilities in a usage sensitive manner is to distribute the local loop costs among customers in proportion to their toll usage. If every customer used exactly the same amount of toll, no one customer would be subsidized. Toll calls would continue to be overpriced and thereby discourage the use of the toll network, but at least every customer would be contributing through toll rates the amount of money which just equals the amount of subsidy or benefit he received on his local exchange loop.

Of course, this is not the case. A relatively small percentage of our customers make a large percentage of the toll calls. In Missouri 5% of our business customers use 77% of the total minutes of business toll calls. Only 25% of our business customers provide 88% of our business toll revenues. This situation is highly beneficial to customers who make few or no toll calls because a significant part of the costs of the facilities dedicated to their exclusive use are paid by these heavy toll users

It is this pricing system coupled with the explosion of competition, or options, which has created the real and present threat of bypass. Bypass is the latest buzz word in our industry. Actually, bypass is simply a shorthand way to express the fact that customers have alternatives or options in their toll services as a result of competition.

The fundamental message is that bypass is the greatest threat to the continued viability of the telephone network and to the concept of universal service. And that the greatest protection against bypass lies in the cost-based pricing principles of the F.C.C.'s access charge plan.

Today, the higher users of toll service have strong economic incentives to arrange their toll services so that they do not have to make a contribution to the non-traffic sensitive costs of other customers. This can be accomplished by bypassing the local network. Dr. Joseph Kramer of Touche Ross and Company testified last year before the Missouri Public Service Commission that 21% of our largest customers in Missouri were already engaging in some form of bypass. Remember that I previously said 25% of our business customers in Missouri accounted for 88% of our total business toll revenues.

When these large volume customers leave our network, not only do we loose the contribution or subsidy they had been providing, but also facilities formally used by them are left idle or "stranded" to be paid for by those customers who remain on the network. The nature of bypass is that it produces a vicious cycle. The more customers drop off the network, the more costs are left to be paid for by the ever shrinking base of customers which leads to higher prices which cause more customers to bypass, and so on.

The F.C.C., after extensive comments and analysis, has implemented a part of its interstate access charge plan. The plan includes flat rate end user charges to be paid by all customers of telephone service in order to recover, at least, part of the non-traffic sensitive costs which result from that customer. Initially this flat rate charge will be applied to business customers who have two or more telephone lines. In Missouri, for Southwestern Bell customers, this charge is $4.70 per month for each local exchange access line. Because customers will be paying a large part of their access non-traffic sensitive costs, the threat of bypass can be forestalled. The industry is moving toward a cost-based pricing method that is absolutely necessary for the long term viability of the local telephone companies in this competitive environment.

Let me say at this point that this end user charge has nothing to do with how much an individual customer uses interstate toll service. Customers do not pay this charge for the privilege of accessing the interstate toll network. (Some have incorrectly characterized the end user charge in this manner.) Rather, the customer is paying directly for the non-traffic sensitive cost of his telephone service which was assigned to the interstate jurisdiction. Costs which exist because of his having telephone service and costs which are the same regardless of whether or not he makes any toll calls at all. This is necessary because those who formerly paid these costs, heavy toll users, are no longer a captive market because of competitive alternatives and are therefore able to bypass the local network to complete their toll calls.

While I have discussed the negative side of the results of competition, we should not forget all of the positive effects. Customers, including small business customers, are now able to purchase their telephones and other equipment, frequently at substantial savings. Thousands of customers, including small business customers, have reduced their toll bills both as a result of AT&T's reduction in prices, but also by using the services of other carriers such as MCI, Sprint, S.B.S., and numerous other providers of toll services including WATS resellers. In Missouri, we proposed and the Commission approved Local Measured Service for our residential and business customers. This service allows any customer to reduce his monthly charges if he places fewer than the average number of outgoing local calls. This service should be especially valuable to small businesses in the service industries such as beauty parlors, bakeries, gasoline stations, etc.. The net result of all these changes is that the potential to save from competitive services and through the use of LMS may more than off set the additional federal end user charge.

The shift to an economically sound pricing method - a method mandated by competition - will result in the very best possible environment for the provision of high quality local exchange service at affordable prices.

I hope this overview of our industry has helped demonstrate to the task force the reason the F.C.C. plan and the preservation of universal service are in harmony. The F.C.C., along with others, recognizes that the telecommunications industry is in a transition to a competitive environment, and that this transition must be managed carefully and responsibly. Southwestern Bell believes that the F.C.C.'s plan is reasonable and will benefit the general public in the long term.

Thank you again for this opportunity to appear before you and to provide you our views on this important topic.

Royce S. Caldwell
Assistant Vice President
Southwestern Bell Telephone Company
St. Louis, Missouri

Mr. **Wyden**. Mr. Cashwell.

TESTIMONY OF RICHARD B. CASHWELL, PRESIDENT, MIDWEST GROUP, UNITED TELEPHONE SYSTEM

Mr. **Cashwell**. Thank you.

I would like to thank the task force for allowing me to represent my customers and my company.

I am president of six United Telephone Companies in the Midwest. Those States are Arkansas, Nebraska, Minnesota, Iowa, Wyoming, Kansas, and Missouri. Three of the companies that I represent are among the smallest in the entire United Telephone System. I have a few medium-sized communities but by and large, I serve primarily rural communities and rural customers. I have about 265 exchanges, of which 65 percent or 172 of them serve less than 1,000 customers each.

In Missouri we average about 22 customers per square mile.

In Kansas we average less than eight per square mile. I give you these facts simply to tell you that although I represent United Telephone System, the customers I serve and the companies I represent are predominantly rural mid-America.

My principal concern today is for the customers that we are presently serving and for the preservation of universal service.

We serve presently about 94 percent of all the households in our serving territory, and, quite honestly, the business that we are in is primarily local telephone service, and if it does not survive, not only am I out of business, but the customers that I serve will be.

When I look at what is happening to our industry today that is being driven primarily by technology resulting in deregulation of a lot of the services that we used to provide and resulting in competition, it is clear to see that these things are generating the concept that is kicked about quite a bit known as bypass.

I am sure that I need not tell the committee that the bypassing of the network will in the long run reduce revenues substantially. They are already reducing revenues. We have been experiencing bypass for quite some time, and I see no way that it will not continue and, in fact, accelerate.

As we look at the possibility of continuing to hold our customers and the preservation of the universal concept of service for everyone, the only solution that I see is the FCC access charge plan. It is not a plan that was conceived overnight. It is a plan that was thought through over a number of years with certainly many hearings and many different portions of the communities across the land helping to put together.

In my opinion, there are some basic reasons why the FCC plan is good.

First of all, it will lower toll rates for everyone, and that is for the small customer as well as the large customer.

It will decrease uneconomic bypass.

It keeps a maximum number of customers on the network.

It provides a revenue pool for high cost companies.

It provides the opportunity for commissions to exempt low-income people from having to pay the access charge.

A reduction in toll rates would certainly stimulate the use of the network substantially and generate some revenue.

Mr. SKELTON. Mr. Chairman, may I interrupt this gentleman at this point?

Mr. WYDEN. Please.

Mr. SKELTON. You are speaking in favor of the FCC order, is that correct?

Mr. CASHWELL. Yes, sir.

Mr. SKELTON. The order has a moratorium on it regarding individual residences and one-line small businesses, is that not correct?

Mr. CASHWELL. Yes, sir, that is correct.

Mr. SKELTON. You would be in favor, then, of putting access charges on the individual customer and on the individual small business?

Mr. CASHWELL. I will address that in just a moment, if I may.

Mr. SKELTON. Yes, please. That is my question.

Mr. CASHWELL. I was really speaking generically to the entire plan now, that there are different provisions of the plan that attempt to address both the low-income people, the high cost companies, and the matter of overpriced toll.

Mr. SKELTON. Maybe I am getting you a little ahead of yourself, but I would appreciate your addressing that.

Mr. CASHWELL. Yes, I certainly will.

Moving to the specific case of small businesses, I took some of the numbers that we are dealing with today and made an example of what our small business customers are experiencing right now; and in our particular Midwest group companies, the average access charge that our small business customer is paying today is $5.65 a line. Our average business customer has two to three lines per business, and that equates to $13 a month or $156 a year.

At the same time that those charges went into effect, a 6.1-percent decrease was ordered in toll rates. We examined these same businesses to see what impact that would have on their toll bill; and assuming that half of the toll bill was interstate, that saved each of those customers on the average $60 a year. You net that against $156 and that leaves our customers on the average paying $96 annually.

Mr. WYDEN. Let me stop you right there because this is very, very helpful, and we appreciate your doing this.

In that period, are their long-distance rates going to go up—excuse me, their local rates going to go up? I mean, you have told us about how you calculated for the small businesses, that their long-distance bill was going to go down from $156, I think you said, to $96. What has been the effect for their local rate during that period?

Mr. CASHWELL. You mean the local, individual rate?

Mr. WYDEN. Yes.

Mr. CASHWELL. Residences?

Mr. WYDEN. No. You are talking about businesses. What will be the local rate during that very same period?

Mr. CASHWELL. Well, this is a snapshot picture. In other words, we looked at the—$5.65 is the access charge that went into effect in May.

Mr. **Wyden**. It is very helpful, but we need to complete the snapshot. You see, our contention, sir, all along has been that people's long-distance rates are going to go down a little bit, but their local rates are going to more than increase by the amount their long distance went down so they are going to go in the hole. Your snapshot is very good, but you have given half the picture. You have given the long-distance picture. Now paint for me the local picture so we can add the two of them up and determine how they are doing.

Mr. **Cashwell**. There is no local increase proposed other than the access charge which I have used in this computation.

Mr. **Skelton**. Would it help to have an example of someone that does not make long-distance calls? Would that help you?

Mr. **Wyden**. But he averages customers.

Mr. **Cashwell**. Those customers with 10 access lines and below.

Mr. **Wyden**. You gave me the answer to the question. You said there is going to be no increase in local rates during that period.

Mr. **Cashwell**. When I say that period or you say that period, there was no local rate increase proposed for this particular group of people as a result of any of the considerations that I took into effect here.

Mr. **Wyden**. Again, I want to be very clear why this is so important. You have told us that the long-distance rates for your people on the average are going to go down from $156 a year, they are going to go down $60, and they are going to pay $96 a year, which is great. That is what we want, we want them to go down. But what we need to know to really analyze whether this FCC proposal has been good is what is going to happen to their local rate during that period. Based on what you told me, their local rates are not going to go up. So for the year, on the average, your people are going to come out $60 ahead, is that right?

Mr. **Cashwell**. No. The difference in the $60 and $156 means that they are, in fact, paying $96 annually more than they were paying before access charges went into effect. If you also take into effect the tax advantage of a business, then if you assume, say, a 30-percent tax rate, they wind up paying annually $67.20 which, to me, seems to be a minimal price to pay for helping us to preserve the national universal service. And not only does it help preserve that service, it actually places the cost on the person who generated that cost.

Mr. **Wyden**. I am not going to interrupt your testimony any longer. Everybody wants to help maintain universal service. The question is whether everybody is going to share the burden proportionately, and that is why we are examining this issue because the evidence seems to be that the small business person is paying a disproportionately large share of the burden of universal service; and I will look over your testimony. But the key proposition, to come back to it, is what we are seeing is that people's long-distance bills are going down a little bit because of the 6.1-percent reduction, but local rates for the small businesses more than make up for it more than offset it with an increase, and then they come out in the hole and that is what our constituents are so unhappy about.

Mr. **Cashwell**. Any local rates that we might propose would be because of additional costs otherwise or inflation as opposed, though, to dealing with the issue of access charges or toll rates.

Mr. WYDEN. Please finish up.

Mr. CASHWELL. I would like to offer just one other piece of supporting evidence to the fact that it is my belief that the access charges which the small business customer is currently paying is not overwhelming. I examined the report or had someone in my company examine the reports that we receive on our hotline which is available to our customers for registering complaints. We also keep up with commission complaints. And since access charges came into effect, the complaint I heard this morning here in this hearing room is the first complaint that we have had that has come to my attention or that I could find out about in my companies, and I am not suggesting that we do not have some small business people who are unhappy about it. The point I am making, though, is I do not find a ground swell of people raising up and complaining tremendously about it. Obviously, we do not have a lot of history yet, it has not been in effect very long. I am not trying to jump to conclusions. I am simply saying at this point what data we have does not demonstrate a real outcry that this small increase is really jeopardizing their business.

In conclusion, and on behalf of my customers and my company, which is the only reason I exist in my job, is that we strongly support the idea that the FCC access charge plan has built into it the various piece parts to protect all segments of my customer base, which is primarily rural, the high cost fund, the ability for the local States to exempt from the access charge, the fact that toll rates could come down very substantially, keeping a lot of people on the network and continuing to pay in revenues that can help finance the high cost fund.

If a bypass were to really get dramatic—the initially proposed high cost fund, I believe, was about $1.2 billion nationwide—it is still going to take some revenue to keep that fund financed. Quite candidly, my company is already experiencing bypass.

As I have said, we serve predominantly rural communities and rural people, so I am vitally interested in seeing that the universal network is preserved and that there are methodologies to protect the small companies and the low-income people.

Thank you for the opportunity to be here.

Mr. WYDEN. Thank you, sir.

[Mr. Caldwell's prepared statement follows:]

PREPARED STATEMENT OF RICHARD B. CASHWELL, PRESIDENT, MIDWEST GROUP, UNITED TELEPHONE SYSTEM

Mr. Chairman and members of the Task Force, I am Richard B. Cashwell, President of the United Telephone System - Midwest Group headquartered in Overland Park, Kansas. The Midwest Group is one of nine operating groups of telephone companies in the United Telephone System. The Midwest Group consists of six companies in seven states; Missouri, Arkansas, Iowa, Minnesota, Kansas, Nebraska and Wyoming. These companies share the Task Force's concern about the need to preserve universal telephone service in this country. We believe, however, that full implementation of the FCC's Access Charge Plan, as presently constituted, is the best method to enable telephone companies to continue to provide service at reasonable rates.

The six Midwest Group companies provide local exchange telephone service and other ancillary services in local exchange areas and are among the companies who jointly provide intraLATA long distance services. Three of our six companies are among the smallest in the United Telephone System. Although we serve a few medium size towns and a very few large customers, our customer base is predominantly small rural communities and rural subscribers. Of the 265 exchanges in the Midwest Group, 172 or 65% of them serve fewer than 1,000 customers. The Midwest Group serves 408,179 access lines with over 483 million dollars invested in property, plant and equipment. We employ 2,856 people and generate revenues in 1983 of $227 million.

Before I address specific issues, I think it would be useful to briefly review the economic circumstances that underlie the FCC's end user charge policy.

TELEPHONE NETWORK COSTS AND SEPARATION PROCEDURES

I'd like to begin with the economic characteristics of the telephone network. The basic components of that network, as illustrated in Exhibit A, are:

(1) Customer Premise Equipment (CPE), including the telephone set itself as well as the intra premises or "inside" wiring;

(2) The local loop, or wire that connects the customer with the local central office;

(3) The local central office, or switch, which performs the basic function of setting up the connection between the called and calling party; and

(4) The long distance network.

The cost characteristics of the telephone network are not homogeneous. CPE, the local loop, and even a portion of the local central office, are facilities dedicated to the use of specific individual subscribers. The costs of these facilities are independent of how much they are actually used by the customer. To take a simple example, the cost of a basic telephone set is the same whether the customer uses it 24 hours a day or not at all. Because the costs of these facilities are not affected by usage, they are referred to as non-traffic sensitive, or NTS, plant.

The costs of other components of the network, on the other hand, are affected by usage. For example, the capacity, hence the costs, of the local switch and long distance network are a direct function of the customer's calling volumes. Because the costs of these components of the network are primarily determined by peak usage levels, they are referred to as traffic-sensitive plant.

With that background, let's now turn to the separate but related matter of how these costs, and particularly NTS costs, have been recovered from users of telephone services.

Central to this issue are what are referred to as jurisdictional separation procedures. Under our dual system of regulation of the telephone industry, the FCC is responsible for regulating interstate toll service, and the respective state regulatory bodies are responsible for regulating local exchange and intrastate toll services.

Consequently, it has been necessary to allocate or "separate" the costs of the telephone network between the state and federal jurisdictions in order to determine the appropriate level of rates to be charged for intrastate and interstate services. Jurisdictional separations procedures are the cost allocation methodologies that have been developed to accomplish this function.

At least in principle, the separation of traffic-sensitive plant is relatively straightforward. Because the costs of this plant are a direct function of usage, it makes economic sense to allocate the costs of this plant between the state and federal jurisdictions on the basis of the relative use by intrastate and interstate services.

The allocation of NTS costs, however, is another matter. As was stated by the U.S. Court of Appeals for the District of Columbia Circuit, in its June 12, 1984, Opinion in NARUC vs. FCC, Case No. 83-1225 (pgs. 19-20), "plant costs are non-traffic sensitive when they do not vary with the extent to which the facilities are used. The basic cost of installing and maintaining a local loop, for example, remains the same whether the subscriber, or 'end user', uses a loop to make one call or one hundred, and whether those calls are local or long-distance. Some switching costs, on the other hand, are traffic-sensitive. They, in fact, increase with usage; for example, as more calls pass through the equipment, heavier, or more costly switches must be employed."

Prior to 1943, this essentially economic view of telephone network costs was reflected in separations procedures. Under what was called the "board to board" principle, only the interstate share of long distance facilities (i.e., from toll board to toll board) was allocated to, and recovered from, interstate toll services. Because NTS costs were not affected by toll usage, those costs were recovered directly from customers through local service charges.

In 1943, however, the FCC adopted what is called the "station-to-station" principle of separations. This principle holds that since interstate services, in a literal sense, "use" the NTS plant portion of the network, they should be required to help defray the costs of those facilities. Consequently, separations procedures were revised to allocate a portion of NTS costs, including the costs of telephone sets or "stations" as well as the local loop, to the interstate jurisdiction.

Since then, the method of allocating NTS costs between the intrastate and interstate jurisdictions has been subject to frequent revision, the effect of which has been to allocate an ever greater proportion of those NTS costs to the interstate services. Under the existing SPF (subscriber plant factor) formula, a nation wide average of 26%, or approximately 11 billion dollars, of the total NTS costs of the network are allocated to and recovered from interstate toll services. These allocated NTS costs constituted almost 40% of AT&T's total revenue requirements of MTS and WATS services, prior to the implementation of access charges.

THE FCC'S END USER CHARGE DECISION

The existing separations procedures are largely the product of an era of regulated monopoly. With the advent of competition in the interstate long distance market over the past decade, however, the economic fallacy of recovering NTS costs from interstate toll services revenues has become increasingly apparent.

To place the issue in a more concrete perspective, let's examine the effect of the existing separations procedure at an individual customer level. The average monthly cost of a local loop today is approximately $26. Prior to the implementation of access charges, 26% of these costs were allocated to interstate toll services (approximately $6.75). NTS costs amounted to an average of about 15¢ per minute of use.

This arrangement is obviously beneficial for customers making no interstate toll calls, who thereby enjoy a local service for a total price that is some $6.75 lower because of the contribution being made by the interstate services. However, for customers who make interstate toll calls, the benefit of the toll contribution to local rates is to varying degrees offset by "inflated" toll charges. For instance, a customer who makes three fifteen-minute interstate toll calls will be contributing 15¢ per minute to the toll charges, or $6.75 to cover the NTS cost allocated to interstate toll services, therefore offsetting the $6.75 subsidy to his/her local rates.

Simply put, the effect of existing separations procedure is to redistribute part of the cost of local loops among subscribers in a manner proportionate to toll usage. If all subscribers made exactly the same amount of interstate toll calls, the net impact of this practice would be nil. That is, each customer would be contributing, through interstate toll rates, an amount exactly equal to the reduction for local rates made possible by the toll contribution to NTS. (Even then, it should be noted that the allocation of NTS costs to interstate toll service has the perverse economic effect of overcharging for toll calls and thereby artificially discouraging usage of the toll network.)

In fact, however, a large proportion of interstate calling is generated by a very small portion of telephone service subscribers. To take a fairly typical example, one Bell Operating Company (BOC) reports that 1% of its business customers account for 42% of its total business MTS revenues, and 10% account for 75% of those revenues.

Thus, the effect of allocating NTS cost to the interstate jurisdiction and recovering those costs through toll charges is to require high volume users to contribute to, or subsidize, the cost of facilities dedicated to the use of other subscribers. To give an example, a customer making 4,000 minutes of interstate toll calls in a month would be contributing about $600 to the recovery of NTS cost, or about 30 times the cost of the local loop used to service that customer.

In the era of regulated monopoly, high volume users had little choice; they either paid the going rate or they didn't use the service. In today's environment, however, competition is providing these customers with an increasing variety of options by which they can "bypass" the local switched network and avoid the subsidy built into the charges for using the network to originate and terminate long distance calls.

Continuing the extraction of NTS contribution from toll services provides an artificial or uneconomic incentive for large volume users to bypass the network. Customers will be induced to utilize intercity services that are less expensive relative to traditional carriers' tariff rates but more expensive relative to the traditional carriers' underlying costs. Exchange carriers will lose those customers who currently provide a substantial portion of the NTS contribution. Simply put, Local Exchange Carriers will not be able to require high volume toll users to subsidize other customers in a competitive market place.

The FCC's Access Charge Plan was a direct and rational response to the threat of uneconomic bypass. What the FCC's end user charge plan requires is that NTS costs be recovered from the causer of those costs - the end user. Not only does this change in the method of NTS cost recovery forestall the threat of uneconomic bypass, it also moves the industry towards cost-based pricing - a necessary step for the long-term survival of local exchange carriers in an increasingly competitive environment.

THE EFFECT OF END USER CHARGES ON SMALL BUSINESS TELEPHONE RATES

The FCC's end user charge plan has elicited considerable concern about the impact of those charges on small business users. Indeed, the Small Business Telephone Task Force was created to address precisely those concerns.

In responding to those concerns, I would first like to reiterate an essential point. The end user access charge has nothing to do, and should have nothing to do, with whether or how much an individual customer uses interstate toll services. From an economic perspective, the end user charge is simply a reflection of the fact that NTS costs are caused not by toll usage but by the individual customer's, or end user's, decision to subscribe to telephone service, and therefore should properly be born by that customer.

Thus the FCC's end_user charge plan requires small business users, like all other users, to do nothing more than to cover the cost of local exchange facilities provided for their use.

While I appreciate the Subcommittees concern with the impact of end user charges on small business, I believe that concern is not warranted; and that, indeed, the potential impact on this class of subscriber has been grossly exaggerated.

For example, in the territory served by United Telephone's Midwest Group, there are 9,701 Key System accounts. The profile of these customers is shown in Exhibit B. The average account has 2.3 lines and generates $164 per month for normal long distance calling (message toll service, or MTS), $112 per month for line, equipment and network services, and $23 per month for directory advertising. The average customer, then, generates approximately $299 of revenue per month for the Midwest Group. Actually, this is conservative because revenues from WATS calling are not included. Based on the revenues just described, these customers account for approximately 42% of the revenues from the business sector.

Returning to the typical two-line Midwest Group small business subscriber, the increase resulting from the weighted average Midwest Group multiline business end user charge of $5.65 is about $13.00 per month. This amounts to about $156 per year. That increase is offset by two factors. One is the recent 6.1% reduction in the interstate long distance rates, which will decrease even more as more of the FCC Access Charge Plan (particularly, residential end user charges) is implemented. The other offsetting factor is the small business customer's ability to deduct his telephone bill as a business expense for income tax purposes. Thus it is possible that the customer would feel no effect at all, or may even experience a net decrease in his/her bill. At worst the cash flow impact upon his/her business will almost certainly be less than $100 per year.

I do not believe that this effect portends financial hardship for the small business sector of the economy. Thus, I urge the Subcommittee not to take any action that would reduce or eliminate the end user charges currently in effect. They are essential for the telephone industry to move from a regulated monopoly environment to a cost-based, competitive arena.

BYPASS

I must emphasize that the alternative to pricing telephone service so as to more closely recover the cost from the cost causer is bypass. In the words of the FCC, "bypass is an actual threat and present danger." (Third Report and Order, released February 28, 1983, in Docket Number 78-72, Phase I, paragraph 107.) The U.S. Court of Appeals for the District of Columbia Circuit recently held that"... the FCC's treatment of the bypass issue is adequately reasoned ..." (Opinion, dated June 12, 1984, in NARUC vs. FCC, Case No. 83-1225, page 45).

As that same court noted, Western Union, for example, already has a growing investment of over $100 million in local distribution facilities as part of a specific program to reduce its dependency on the Bell system (pg. 45-47). Some parties have suggested that the problem can be cured by denying potential bypassers permission to construct facilities; but, both the FCC and the Court (pg. 47) rejected this proposal as unsound and unworkable. To the extent that access charges to inter-city carriers are set at excessive levels, there can be little doubt that interstate users will be encouraged to invest in unnecessary and duplicative facilities. The Court concluded that "... FCC sufficiently established the existence of bypass as a real market force." (pg. 49)

Moreover, once begun, the debilitating effects of bypass will spread. The nature of bypass is that it produces a vicious spiral-effect; that is, the more customers that drop off the network, the more costs that are left for the remaining customers to bear, which will cause higher rates that will force more customers to cancel service, and so on. All customers need to understand, appreciate and accept the need for moderate increases in telephone rates to cover continuing costs of service. Otherwise, prohibitive rate increases will surely result due to uneconomic incentives to bypass. Unless these facts are understood and accepted, the telephone industry faces a downward trend in revenues and earnings which will lead to financial ruin.

More importantly, it must be recognized that in the environment of interstate access charges, the impact of bypass is not limited to just those telephone companies which have large customers that leave the local network for alternative communication routes. The interstate Carrier Common Line Charge is calculated, essentially, by dividing the allocated non-traffic sensitive access costs by the forecasted minutes of use. If an exchange carrier is subsequently bypassed, it will obviously not experience or charge for the minutes of use it had expected. Thus, that carrier will pay into the Carrier Common Line Pool less revenues than were anticipated for the year. So long as participation in the interstate Carrier Common Line Pool is mandatory, exchange carriers will be effectively precluded from recovering from the Pool the authorized rate of return. Therefore, if the FCC's plan is not put into effect, the price per minute of use to the intercity carrier would have to increase to recover this shortfall, and the problem of bypass will be aggravated. In other words, the vicious spiral-effect of bypass can and will eventually adversely impact all exchange carriers.

Significantly, a Congressional committee has recognized the evil of bypass. A study entitled: "The Economic Issues of Changing Telecommunications Industry" was issued by the Joint Economic Committee, to the Congress of the United States, on October 3, 1983. The study written by staff economist Dale Jahr, succinctly states that; "Universal service is jeopardized by both (customer) dropout and bypass, but bypass is the largest threat to the economic feasibility of the public phone network ... This applies to all areas of the country, high cost and low cost alike" (pg. 16-17).

Mr. Jahr has subsequently addressed these same principles in a Staff Study prepared for the Joint Economic Committee of the Congress, dated March 1, 1984, entitled "Public Policy Considerations of Pricing Telephone Services."

The Congressional Budget Office (CBO), Congress of the United States, also addressed these issues in a June, 1984, study entitled "The Changing Telephone Industry: Access Charges, Universal Service, and Local Rates." As has been widely reported, that study does not support the anti-access charge approach that was contained in Senate Bill 1660 and House Resolution 4102. It concluded that such legislation "... might prove difficult to administer and have unintended consequences for the development of new technologies." (pg. 13). Instead, the CBO suggested that:

"The Congress might choose to take no action and permit the FCC to implement its access charge program. A 'do nothing' approach could be justified for several reasons. First, changes in telephone rates might be viewed as being similar to price changes for other services. While all price changes tend to benefit some individuals at the expense of others, the government does not normally seek to freeze prices in the attempt to protect individuals who might otherwise suffer. Second, the level of access charges now proposed -- limited to $4.00 monthly until 1990 -- might not be considered to be high enough to cause extreme hardship. Third, the FCC has proposed to establish a Universal Service Fund to assist the subscribers of high-cost companies and is now supporting means to exempt low income subscribers from access charges" (pg.44).

Finally I must refer to the June 12, 1984, opinion of the U.S. Court of Appeals of the District of Columbia Circuit, in the case of NARUC vs. FCC, No. 83-1225. After an exhaustive analysis of all the arguments against the FCC's Access Charge Plan, the Court affirmed the general principles contained therein by saying that:

"Over five years' study of complex and far-ranging issues set the foundation for the FCC's order in this case. The Commission predicted industry trends and the impact of rate changes, reconciled widely diverse policy goals and numerous competing interests, and devised solutions to novel and difficult problems. Confronting rapid and fundamental changes in the telephone industry as a result of competition and fast moving technology, the FCC acted for the most part with flexibility and care. The Commission's work fell short of the ideal at several turns but our review does not and cannot require perfection. (Citation omitted); Voltaire, Dictionnaire Philosophique (Dramatic art) (1794) "Le mieux est l'ennemi du bien" ...The best is the enemy of the good).

"We do not find unreasoned the Commissions' determination that, to the extent practical, telephone prices should be based upon the true cost characteristics of the telephone company plant. (Citation omitted) Nor, with limited exceptions, can we quarrel with the FCC's exercise of judgement in deriving workable formulas, estimating numbers that cannot be mathematically proved, and making equitable assessments of the speed with which changes should be introduced.

"Further refinements to the FCC's plan could be debated endlessly. However, the Commission has reached a point in its deliberations where 'a month of experience will be worth a year of hearings'." (Citation omitted) The FCC has not achieved a plan of pristine quality. But in the words of Voltaire: 'Perfection is attained by slow degrees; it requires the hand of time.' (Citation omitted)."

I respectively urge the Subcommittee to heed the wisdom of these words, and not seek by legislation to reverse any part of the FCC's Access Charge Plan now in effect. Thank you very much.

R. B. Cashwell

President

United Telephone System - Midwest Group

EXHIBIT A

JOINTLY USED, OR COMMON, TELEPHONE FACILITIES

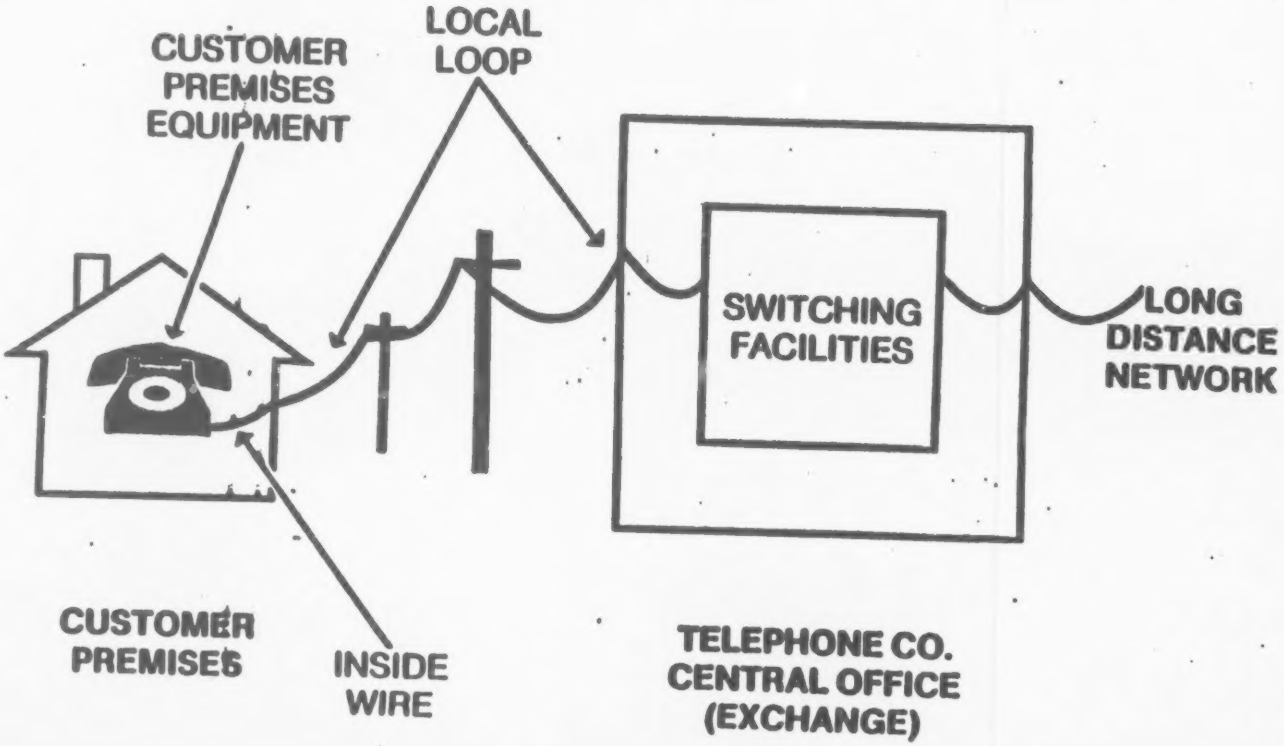
CUSTOMER PREMISES EQUIPMENT
LOCAL LOOP
SWITCHING FACILITIES
LONG DISTANCE NETWORK
CUSTOMER PREMISES
INSIDE WIRE
TELEPHONE CO. CENTRAL OFFICE (EXCHANGE)

Exhibit B

UNITED TELEPHONE SYSTEM - MIDWEST GROUP

KEY SYSTEM ACCOUNTS*

1.	Accounts	9,701
2.	Lines	22,632
3.	Lines/Accounts	2.3
4.	Long Distance Revenues/Month	$1,586,632
5.	Long Distance Revenues/Account	$164
6.	Recurring Revenues/Month (Lines, Equipment, Network Service)	$1,081,731
7.	Recurring Revenue/Account	$112
8.	Directory Advertising Revenues/Month	$227,161
9.	Directory Advertising/Account	$23
10.	Total Revenue/Month	$2,895,524
11.	Total Revenue/Account/Month	$299

* As of 7/16/84.

Mr. **Wyden**. Mr. Copsey.

TESTIMONY OF EVAN R. COPSEY, PRESIDENT, FIDELITY AND BOURBEUSE TELEPHONE COMPANIES

Mr. **Copsey**. Good afternoon, Mr. Chairman, Congressmen, and members.

It certainly is a privilege and an honor to appear before you today.

I am Evan Copsey of Sullivan, MO, president of the Fidelity and Bourbeuse Telephone Cos., also of Sullivan, a rural area some 70 miles southwest of St. Louis.

I have been fairly active in the past few years trying to express my concerns for the future of universal telephone service, the survival of the smaller telephone companies, and, last, but not least, the 9,800 subscribers who are located in the exchange areas which the Fidelity and Bourbeuse Telephone Cos. serve.

Changes have taken place as a result of the divestiture. Early on Judge Greene said, "Independents, do not worry, you are transparent to the divestiture." I know now part of what transparency means, and I am still learning. I do not think the small Telcos could stand to have been opaque.

As a result of the settlements process, which divided toll revenue, changing to a new process, "access charge," a requirement of the MFJ and also the FCC, we have had to increase our work force by two people just to fill out the forms required and to collect additional data. The effect, when expressed as cost to the customer, is in the magnitude of $5 per customer per year.

This by no means is all. There are several other items of increased cost that I have not tried to quantify.

Somehow, some way, the fodder, the paper, the extreme precision of gathering data has to be modified and modified to the degree that makes sense in a competitive business. We, and in turn the customer, should not be subjected to these additional cost requirements.

One interesting thing that will come about in a competitive arena is the differential between business rates and residential rates, which, over time, will tend to come together, the differential will disappear.

Bypass. I am sure that you have heard this term many times, and I suspect that each time you have heard this term a different definition has been used and each of them probably are correct. Bypass means several things. To a monopolist a definition would be use of someone else's facilities rather than the monopolist's. The one you have heard the most is uneconomic bypass. This phenomenon is brought about by the pricing and costing of telephone services in a monopoly environment sanctioned by both the telephone companies and the regulators, and it is where other companies, not the traditional telcos, build their own facilities to use rather than use the telco's, thereby avoid paying prices based on costing as it is today. To me, perhaps I should say the residential and small business telephone user, bypass means that their telephone bills will go up.

Low depreciation rates has been one of the largest single items to create the dilemma we find ourselves in today. In an era of rapidly changing technology, expanding not linearly but geometrically, unrealistic low depreciation rates have caused the use of some technologies to be stymied. In the past many regulators have taken a shortsighted approach in an effort to keep monthly service rates low and have required unrealistic low depreciation rates. This has, in effect, caused the telephone user to be deprived use of some technologies and certainly will cost him more in the longrun.

I want to take this opportunity to congratulate the FCC for taking the bull by the horns and issuing more realistic depreciation rates. The result of this action will be to help insure that the telephone user, both large and small, will have access to the latest technology as we enter the information age. Functionally, from a long-term standpoint, telephone service to the customer will be cheaper.

It does not require an economist to see what currently is happening. Today the FCC is busy promoting competition. Why? It is in the public interest. The point I would like for this committee to consider is, when a regulatory body imposes different rules, and I mean different costing rules, on two separate entities that provide the same type of service, one of two things will happen, either the costing rules and the regulations will be brought together or the company saddled with the highest costing rules will become extinct. Who is going to pay for this poor regulation? I suspect it is going to be the stockholders of the telephone companies as well as the residential and small business telephone user.

In summary, please consider, one, requesting the FCC not to bury the small telephone companies in noncost effective paperwork, regulations, and requirements.

Mr. **Skelton**. Let me interrupt right there, Mr. Chairman.

The subcommittee which I now head, as a matter of fact—and I just made a note here for our staff director—that the Federal Paperwork Act that was designed to decrease the use of paperwork in the Federal Government and among the populace evidently has not been looked at or applied here, and we are going to see if it has any applicability to you folks. We are going the wrong direction. I know a lot of work on our subcommittee went into that; and if we get any positive answer, we will get back to each of you.

Mr. **Copsey**. I appreciate that.

Mr. **Wyden**. As you finish up, I want to associate myself with Mr. Skelton's remarks because we are going to be making recommendations on November 30. I just guarantee you one of them is going to be some kind of streamlining of reporting requirements. You gentlemen, quite frankly, have been polite today, and many of the comments I have heard on this point have not been as diplomatically stated.

Mr. **Copsey**. Thank you.

Two, drafting and passing legislation that prevents regulators and their staff from entering industry associated or regulated by the agency they worked for for a period of 3 years. It is hard to realize the magnitude of the dividends this action could have on all Americans.

Three, if and when life line service is established, do not put the telephone companies in the welfare business but rather let it be administered by one of the welfare agencies already in place.

Four, rather than wait until the horse is out of the barn, start immediately with the new Congress and establish how universal service is to continue or even hope to be continued when local exchange service is thrown open to competition. I guess what I am saying is you, Congress, need to start thinking and planning of how you are going to provide telephone service to rural areas of this country and how you are going to operate it, add it to the Post Office? Do you suppose some of the Post Office problems are related to bypass?

Thank you for the opportunity of appearing today.

The WYDEN. Thank you very much.

[Mr. Copsey's prepared statement follows:]

PREPARED STATEMENT OF EVAN R. COPSEY, PRESIDENT, FIDELITY AND BOURBEUSE TELEPHONE COMPANIES

GOOD MORNING MR. CHAIRMAN, MEMBERS. IT CERTAINLY IS A PRIVILEGE AND HONOR TO APPEAR BEFORE YOU AND YOUR COMMITTEE TODAY.

I'M EVAN COPSEY OF SULLIVAN, MISSOURI, PRESIDENT OF THE FIDELITY AND BOURBEUSE TELEPHONE COMPANIES, ALSO OF SULLIVAN, MISSOURI, A RURAL AREA SOME 70 MILES SOUTHWEST OF ST. LOUIS. I HAVE BEEN FAIRLY ACTIVE IN THE PAST FEW YEARS TRYING TO EXPRESS MY CONCERNS FOR THE FUTURE OF UNIVERSAL TELEPHONE SERVICE, THE SURVIVAL OF THE SMALLER TELEPHONE COMPANIES AND LASTLY, BUT NOT LEASTLY, THE 9800 TELEPHONE SUBSCRIBERS THAT ARE LOCATED IN THE EXCHANGE AREAS WHICH THE FIDELITY AND BOURBEUSE TELEPHONE COMPANIES SERVE.

CHANGES THAT HAVE TAKEN PLACE AS A RESULT OF DIVESTITURE — EARLY ON JUDGE GREEN SAID, "INDEPENDENTS" DON'T WORRY, YOU ARE TRANSPARENT TO THE DIVESTITURE. I KNOW NOW PART OF WHAT TRANSPARENT MEANS AND I'M STILL LEARNING. I DON'T THINK THE SMALL TELCO'S COULD STAND TO HAVE BEEN OPAQUE.

AS THE RESULT OF THE SETTLEMENTS PROCESS, WHICH DIVIDED TOLL REVENUE, CHANGING TO A NEW PROCESS "ACCESS CHARGE" A REQUIREMENT OF THE MFJ (MODIFIED FINAL JUDGEMENT) AND ALSO THE FCC (FEDERAL COMMUNICATIONS COMMISSION), WE HAVE HAD TO INCREASE OUR WORK FORCE BY TWO PEOPLE JUST TO FILL OUT FORMS REQUIRED AND TO COLLECT ADDITIONAL DATA. THE EFFECT, WHEN EXPRESSED AS COST TO THE CUSTOMER IS IN THE MAGNITUDE OF $5.00/

CUSTOMER/YEAR. THIS BY NO MEANS IS ALL. THERE ARE SEVERAL OTHER ITEMS OF INCREASED COST THAT I HAVE NOT TRIED TO QUANTIFY.

SOMEHOW, SOME WAY, THE FODDER, THE PAPER, THE EXTREME PRECISION IN GATHERING DATA HAS TO BE MODIFIED AND MODIFIED TO THE DEGREE THAT MAKES SENSE IN A COMPETITIVE BUSINESS. WE, AND IN TURN THE CUSTOMER, SHOULD NOT BE SUBJECTED TO THESE ADDITIONAL COST REQUIREMENTS.

ONE INTERESTING THING THAT WILL COME ABOUT IN A COMPETITIVE ARENA IS THE DIFFERENTIAL BETWEEN BUSINESS RATES AND RESIDENTIAL RATES WILL, OVER A PERIOD OF TIME, TEND TO GO AWAY.

BYPASS – I'M SURE THAT YOU HAVE HEARD THIS TERM USED MANY TIMES, AND I SUSPECT THAT YOU HAVE HEARD THIS TERM DEFINED DIFFERENT WAYS AND EACH OF THEM ARE CORRECT. BYPASS MEANS SEVERAL THINGS. TO A MONOPOLIST A DEFINITION WOULD BE, USE OF SOMEONE ELSE'S FACILITIES RATHER THAN THE MONOPOLIST. THE ONE YOU HAVE HEARD THE MOST IS UNECONOMIC BYPASS. THIS PHENOMENON IS BROUGHT ABOUT BY THE PRICING AND COSTING OF TELEPHONE SERVICES IN A MONOPOLY ENVIRONMENT SANCTIONED BY BOTH THE REGULATORS AND TELEPHONE COMPANIES AND IS WHERE OTHER COMPANIES (NOT THE TRADITIONAL TELCO'S) BUILD THEIR OWN FACILITIES TO USE RATHER THAN USE THE TELCO'S THEREBY AVOIDING PAYING PRICES BASED ON COSTING AS IT IS TODAY. TO ME (PERHAPS I SHOULD SAY THE RESIDENTIAL AND SMALL BUSINESS TELEPHONE USER) BYPASS MEANS THAT THEIR TELEPHONE BILLS WILL GO UP.

LOW DEPRECIATION RATES HAS BEEN ONE OF THE LARGEST SINGLE ITEMS TO CREATE THE DILEMMA WE FIND OURSELVES IN TODAY.

IN AN ERA OF RAPIDLY CHANGING TECHNOLOGY, EXPANDING NOT LINEAR BUT GEOMETRICALLY, UNREALISTIC LOW DEPRECIATION RATES HAVE CAUSED THE USE OF SOME TECHNOLOGIES TO BE STYMIED. IN THE PAST MANY REGULATORS HAVE TAKEN A SHORTSIGHTED APPROACH, IN AN EFFORT TO KEEP MONTHLY RATE INCREASES TO A MINIMUM, AND HAVE REQUIRED UNREALISTIC LOW DEPRECIATION RATES. THIS HAS, IN EFFECT, CAUSED THE TELEPHONE USER TO BE DEPRIVED USE OF SOME TECHNOLOGIES AND CERTAINLY WILL COST HIM MORE IN THE LONG TERM.

I WANT TO TAKE THIS OPPORTUNITY TO CONGRATULATE THE FCC FOR TAKING THE "BULL BY THE HORN" AND ISSUING MORE REALISTIC DEPRECIATION RATES. THE RESULT OF THIS ACTION WILL BE TO HELP INSURE THAT THE TELEPHONE USER, BOTH LARGE AND SMALL, WILL HAVE ACCESS TO THE LATEST TECHNOLOGY AS WE ENTER THE INFORMATION AGE. FUNCTIONALLY, FROM A LONG TERM STANDPOINT, TELEPHONE SERVICE TO THE CUSTOMER WILL BE CHEAPER.

IT DOESN'T REQUIRE AN ECONOMIST TO SEE THROUGH WHAT CURRENTLY IS HAPPENING.

TODAY THE FCC IS BUSY PROMOTING COMPETITION. WHY? "IT'S IN THE PUBLIC INTEREST." THE POINT THAT I WOULD LIKE FOR THIS COMMITTEE TO CONSIDER IS: WHEN A REGULATORY BODY IMPOSES DIFFERENT RULES, AND I MEAN DIFFERENT COSTING RULES, ON TWO SEPARATE ENTITIES THAT PROVIDE THE

SAME TYPE OF SERVICE, ONE OF TWO THINGS WILL HAPPEN. EITHER THE COSTING RULES AND REGULATIONS WILL BE BROUGHT TOGETHER, OR THE COMPANY SADDLED WITH THE HIGHEST COSTING RULES WILL BECOME EXTINCT. WHO IS GOING TO PAY FOR THIS POOR REGULATION? THE STOCKHOLDERS OF THE TELEPHONE COMPANIES AND THE RESIDENTIAL AND SMALL BUSINESS TELEPHONE USER.

IN SUMMARY, PLEASE CONSIDER:

(1) REQUESTING THE FCC TO NOT BURY THE SMALL TELEPHONE COMPANIES IN NON-COST EFFECTIVE PAPERWORK, REGULATIONS, AND REQUIREMENTS.

(2) DRAFTING AND PASSING LEGISLATION THAT PREVENTS REGULATORS AND THEIR STAFF FROM ENTERING INDUSTRY ASSOCIATED OR REGULATED BY THE AGENCY THEY WORKED FOR FOR A PERIOD OF THREE YEARS. IT'S HARD TO REALIZE THE MAGNITUDE OF THE DIVIDENDS THIS ACTION WILL HAVE ON ALL AMERICANS.

(3) IF AND WHEN LIFE LINE SERVICE IS ESTABLISHED, DON'T PUT THE TELEPHONE COMPANIES IN THE WELFARE BUSINESS, BUT RATHER LET IT BE ADMINISTERED BY ONE OF THE WELFARE AGENCIES ALREADY IN PLACE.

(4) RATHER THAN WAIT UNTIL "THE HORSE IS OUT OF THE BARN", START IMMEDIATELY WITH THE NEW CONGRESS AND ESTABLISH HOW UNIVERSAL SERVICE IS TO CONTINUE OR EVEN HOPE TO CONTINUE WHEN LOCAL EXCHANGE SERVICE IS THROWN OPEN TO COMPETITION. I GUESS WHAT I'M SAYING IS YOU (CONGRESS) NEED TO START THINKING AND PLANNING OF HOW YOU ARE GOING TO PROVIDE TELEPHONE SERVICE TO RURAL AREAS OF THIS COUNTRY, AND HOW ARE YOU GOING TO OPERATE IT? ADD IT TO THE POST OFFICE?

THANK YOU FOR THE OPPORTUNITY OF APPEARING BEFORE YOU TODAY.

Mr. **Wyden**. Mr. McClelland.

I want to say as you start, Mr. McClelland, to get some questions in we are going to fight the clock.

TESTIMONY OF ROBERT S. McCLELLAND, JR., PRESIDENT, MISSOURI TELEPHONE CO.

Mr. **McClelland**. I will be very brief.

I appreciate being here today. I am Bob McClelland, president of Missouri Telephone Co.

We serve 17 communities in rural Missouri. The communities range in size from 60 to 6,000. Twelve of our exchanges are under 1,000, the towns are under 1,000, in population.

You have a copy of my remarks so I will be brief.

Our presence here today tells me that there is still a glimmer of hope that some degree of sanity might be returned to our telephone industry.

We are presently in a no-win situation, especially so if universal service and the right to communicate totally in this country have any importance. If we go to full cost base pricing and burden the local rate with all of the nontraffic-sensitive plant costs, then universal service at affordable rates will no longer exist, it cannot. On the other hand, under current policy, if we do not make some changes in the flow of toll revenues, we are faced with the serious problem of bypassing the toll network. Also, there is the problem of bypassing the local network. This has a great effect on universal service. Small companies, for the most part, are unable to keep up with all the changes. Today there are small companies who are not totally receiving their revenues from pools and who are not totally able to bill the National Exchange Carrier Association their portion of the expenses and so forth to keep the revenue flow going like it should be.

The paperwork is staggering. Our small business customers and residential customers are confused and unhappy. In our attempt to keep up, we are experiencing extremely high costs. Our customers are the losers as both their local and toll costs will increase tremendously.

The current access charges that everybody is basing and comparing to the current decrease in toll rates, they are just the beginning. When the average cost of the nontraffic sensitive portion of our plant is $26 nationwide, then that means my average costs are much higher than that. So that is what my customers have to look forward to. We need to slow these things down. We need to know where we are going. There are too many unanswered questions.

Charlie Brown told the world that divestiture would not increase rates, and what happened? As soon as the date passed, every Bell Company in the country filed for the biggest rate increase in their history. The FCC is putting out decisions. These decisions create a lot of problems. Now what happens? Every week they are in a reconsideration meeting.

As I stated in my prepared statement, the barn door is open and this wild horse is rapidly getting out. We may not be able to return him to the barn, but surely we can hold him in a corral until we get him tamed.

Thank you.

Mr. WYDEN. Thank you.

How can reasonable people differ so much?

[Mr. McClelland's prepared statement follows:]

PREPARED STATEMENT OF ROBERT S. MCCLELLAND, JR., PRESIDENT, MISSOURI TELEPHONE CO.

Statement of R. S. McClelland, Jr., President of Missouri Telephone Company, Box 878, Columbia, MO, before the Telephone Task Force of the Committee on Small Business of the House of Representatives, on August 24, 1984.

Mr. Chairman, my name is Bob McClelland. I am President of Missouri Telephone Company. We serve approximately 14,500 access lines in 17 rural Missouri communities. The towns in these communities range in size from 60 to 6,000 in population. Our service area covers approximately 1500 square miles. I have spent 34 years in the telephone business.

I want to thank you and the committee for the opportunity to appear before you today and give my brief comments on how residential and small business customers are affected, due to recent decisions and rulings by the Justice Department and the Federal Communications Commission.

The most important question here today is "How important is universal service at affordable rates in order that we continue to have total communications in our country?" If this is important, then we are headed down the wrong track.

I do not profess to be an expert in all of the changes our industry is faced with today. I am sure the committee recognizes that we are a very complicated industry, and the pressure being applied to quickly solve the many problems we face may not be in the best interest of the public. I am greatly concerned about the high local rates facing our residential and business customers, and the future of the small telephone company. If we small companies have any expertise, it's in the ability to serve rural America with universal service at affordable rates. If we burden our customers with extremely high local rates and increase their cost for message toll service, then eventually we will price our service beyond their ability to pay, and universal service at affordable rates will no longer exist in rural America. I am the first to admit that I have big concerns, and very little in the way of solutions. Following are some of my thoughts in regard to these concerns, and a few suggestions which might ultimately lead to some solutions:

First, I would like to point out that I am certain the committee has received a lot of information in regard to studies, economic evaluations, etc. I have seen many of these, and to me they are having less and less meaning. Things are just moving too fast. Today's figures become obsolete tomorrow. No doubt each party of interest has a tendency, due to human nature, to beef up their studies to prove their points. We have seen some misrepresentation of information concerning the minutes of use used in studies for the ENFIA agreements. As communications companies frantically attempt to get their portion of this new market, we have a tendency not only to overlook rural America, but to analyze the effects on the urban residential rate payer and the urban small business rate payer.

We cannot go to cost-based pricing in rural America and maintain universal telephone service at affordable rates. We must continue to have the revenue support of both local and toll. We must continue to have averaging of message toll service. We cannot disregard the fact that a certain portion of our non-traffic sensitive plant is used for message toll service, and therefore the revenue support from this portion of our plant should not totally be eliminated from the settlement process.

Bypass is becoming one of our biggest problems. If it continues, we will see deterioration of the nation-wide toll network and eventually a degrading of toll service, and higher rates for the average telephone user. A strong, efficient nation-wide toll network must be maintained, as it is very important to our national defense. Also, when bypass facilities fail, their traffic will revert back to the basic network. At this time, bypass is entering the local exchange service area. This means, in addition to losing our large toll customers to the interexchange carriers, we now see the possibility of losing our large local exchange customers. I am sure the committee is well aware of the Teleport, or intelligent building concept, and I would also refer you to the FCC's recent decision in Docket No. 83-1375. If this decision is not reversed, the ATTIS subsidiary of ATTCOM would not only be bypassing our toll facilities, but will be bypassing local facilities also. Even though the problems of bypassing local facilities is more prevalent in the metropolitan areas, it does have an effect on the revenues the larger companies will be providing to the pools which we all share in, and of course, this effect passes on down to the rural companies sharing in these pools. Bypass erodes the revenues flowing into both state and federal pools, and as I am sure the committee knows, state and federal government are becoming the biggest bypassers of our networks.

I find it very difficult to tell my residential and small business customers they will be better off with higher local rates, due to the fact they will experience a savings on long distance calls that will offset the higher local rate. You see, a large percent of our residential and small business customers do not make enough toll calls to enjoy this potential savings. The biggest percent of the calls our customers make are on high cost, low density toll routes, and the projections are that these toll rates will increase tremendously. At this time, 70 percent of our toll calls are intrastate. Our average length of haul on intrastate calls is 38 miles. This means that most of these calls are intraLATA, and are primarily in the community of interest in the area of the customer making the call. Practically all of these toll routes are low density, high cost toll routes. I believe the committee must recognize the fact that not only are low density rural areas affected, but to a large degree, many urban residential and small business customers are affected, and many of these are not making enough toll calls to experience the savings which will warrant the much higher local rates they will see in the future.

We are long past due in recognizing the tremendous cost involved in going through these changes, and asking ourselves, "Who will pay the bill for these costs?" Quite frankly, small companies are having a very difficult time keeping up with these changes, and the paper work involved. Many are experiencing a substantial decrease in revenues because they are having difficulty understanding the billing process, and they are not properly billing everything they should to the exchange and interexchange carriers handling their toll. We must never lose sight of the fact that for the most part, the small companies serving rural America are serving areas no one else wants to serve.

We must also be very much aware of the fact that when local rates increase to a certain level, then the social aspects of the problems come into the picture, and we are faced with the expense of another social program.

As hard as we try to explain to our customers the many changes, they are still confused and upset. Our multi-line business customers find it hard to understand why they must pay a $6.00 access charge for their lines. Our residential customers are also confused in regard to the proposed access charge structure facing them over the next several years. In my opinion, both of these charges are in their infancy, and unless we can change something, they will increase far beyond the amounts we are talking about today.

Quite frankly, I am not sure I have the intelligence to provide solutions to the problems we have today. Our revenues will steadily decrease, due to the loss of customer premises equipment, the loss of revenues flowing through to our companies from the toll settlement process, due to competition in this area, and now the potential loss of revenues flowing to us, due to the new concept of intelligent buildings and teleports affecting the local service areas. I am more and more concerned about the value of our certificate from the Missouri Public Service Commission to serve the areas we have served for many years. We have made a tremendous investment in these areas to provide our customers with high quality universal service, at a rate they have been able to afford. There are very few markets a small rural telephone company can diversify to, in the areas they serve. The future looks very bleak for us.

I am well aware of the fact that we have reached a point in this transition to the new environment which prohibits a return to "as it used to be." However, I firmly believe that steps can and should be taken to hold down the progression of access charges, both for the multi-line businesses and residential customers. On June 1, 1985, a $2.00 access charge is proposed to go into effect for all residential rate payers. This $2.00 charge will progress to $4.00 in 1989.

My recommendation to this committee is that the current access charge of $6.00 now being applied to multi-line business customers, and the proposed $2.00 charge to go into effect on residential rate payers' bills June 1, 1985, be capped at this level until a comprehensive study is made in regard to the total effect these changes will have on local rates. Participants in the study should be the Congress, the industry, the FCC, and the public. Any revenue deficiency experienced from capping the local business and residential rate at this level should come from the intercity carriers. Those who are totally bypassing the network, either by microwave, via satellite, or whatever other means, should pay a surcharge, administered by the FCC for the use of the frequencies involved. The fact that this study would involve several years of hard work is unimportant. What is important is that on our current trend, local rates in many areas will reach a point where customers can no longer afford to pay them. Also, small companies serving high cost, low density rural areas will not survive, and I am sure this committee knows that if this happens, who will pick up the bill for this loss. We all understand it would be the taxpayers, as somebody will have to serve these areas.

In summary, let me say that at this point in time, we've left the barn door open and the wild horse is rapidly getting out. We may not be able to return him to the barn, but surely, we can hold him in a corral until we get him tamed.

Thank you.

Mr. WYDEN. Mr. Harlan.

TESTIMONY OF FRANK HARLAN, VICE PRESIDENT, CONTINENTAL TELEPHONE CO.

Mr. HARLAN. I am Frank Harlan, vice president of Continental Telephone.

I will address my remarks strictly to Missouri, and I will be very brief.

Contel actually serves between 20 and 25 percent of the geographic area of Missouri through 140 exchanges serving about 250 communities. We are very rural in nature. Our exchanges range from 55 access lines to 6,000, with 950 average.

One of the things I did, Mr. Chairman, I did look at specifically the transfer of all nontraffic-sensitive costs to the end user. This is going to increase that end user charge, that local rate, by 2.8 times. Right now our present rate for a single-line business ranges between $12.15 and $16.05. The additional charges for transferring of the nontraffic-sensitive cost to that end user, which also includes that residential customer, is $28.40. So our residential and our business customers will be increased by the end of the 3-year period, assuming that the scenario remains the same, the nontraffic-sensitive cost being transferred to the end user, then that rate is 2.8 times the present rate for a present single-line business.

Mr. WYDEN. So yours would go up more than 200 percent?

Mr. HARLAN. That is correct, sir, and that is the business line. Now, the residential line goes up a higher rate, and I simply took all the non-traffic-sensitive costs, took them to a zero basis, and, in turn, divided them by the access lines we presently have. So that is quite a dramatic increase. Bypass is, of course, a very serious concern to us, and our State government happens to be one of our most serious concerns.

We have also on a corporate basis filed with the FCC on May 21, 1984, on docket 7872 and 80-286, a plan to, shall we say, negate the transfer of non-traffic-sensitive costs. Our plan basically divides that cost by usage. It supports the high cost fund. We are most concerned with the transition period, and we recognize that it is a social factor, and the social factor is something that we agree with Mr. Copsey on, that it must be handled from a social basis and not from a telephone industry basis.

Thank you for allowing us to appear.

[Mr. Harlan's prepared statement with attachment follows:]

PREPARED STATEMENT OF FRANK HARLAN, VICE PRESIDENT, CONTINENTAL TELEPHONE CO.

1. How have the changes in the telecommunications industry - the AT&T divestiture, the FCC's access fee decision, and the FCC's mandated increase in depreciation - affected small telephone companies and small businesses?

Not one telephone company or business, either large or small, has escaped being affected by the FCC's decisions in Docket CC 78-72 (the access charge order) and CC 80-286 (separations charges).

Contel and its subsidiary companies in all jurisdictions have faced many difficulties in dealing with a very complex subject matter and as importantly, in dealing with a changing attitude within our organization.

For over thirteen years, independent companies like Contel have relied heavily on the partnership agreement with the Bell system for operational as well as financial decisions. The parnership has worked very well. Absent competition, it would have continued to work well.

We enjoy the most advanced, sophisticated and well run telephone system in the world.

It is a system, because a cooperative spirit and drive within the industry insured that virtually all people would be afforded telephone service, regardless of the location. Such was the case pre-divestiture.

On January 1, 1984, the system did not, contrary to popular belief, fall apart.

Things are different in a competitive environment. The rules must change and adapt.

The Justice Department broke up the largest corporation in America, but it also had an impact on the other 1400 parties who were silent but affected parties, namely the independents.

Judge Green did not acknowledge us in the modified final judgment, but he did impact us. For it is impossible to break the partnership without affecting all of the members.

In order to introduce a more competitive atmosphere into the Bell system, it necessitated a modification to the partnership. The modification was swift and complete termination.

Contel does not believe this was inherently wrong. In fact, technology had far outstripped the existing division of revenues system and a change was warranted.

We believe we are at the threshold of a limitless range of opportunities for our companies. We will now be the designers and shapers of our financial future, no longer dependent on the Bell system.

We believe there will be continuing modification and change to the structure of access charges in the coming months and years.

We believe this because as we move into the future, we are being driven by advances in technology which require flexible pricing and regulation.

All telephone companies must be afforded the same degree of latitude in pricing as those offered the other common carriers (OCC's), such as MCI and GTE Sprint.

Flexibility and relaxed regulation are the keynotes of the future. Without both, companies like ours will suffer.

2. How will the changes in the telecommunications industry affect telephone rates? By how much will charges be raised per business line?

Contel believes telephone rates will go up. The deloading of Non-Traffic Sensitive (NTS) costs from the existing interstate and intrastate toll rate schedule will push local service rates and customer access line charges up.

The deloading process assures local subscribers will be paying more in the future. The increase is not as easy to quantify because the transition period and the initial end user charges have yet to become reality. However, I would estimate a two and one-half times the present Missouri rates in the next three years.

The impact and swiftness with which rates will increase lies in the hands of the FCC, who will most likely adopt the recommendations of the Joint Board.

Contel is most concerned with the mechanism and the speed of the deloading process.

A swift move from the pre-divestiture "business as usual" approach which recognized a subsidy from toll rates to a cost based toll tariff means that tremendous imbedded costs, making up over 50% of our company's total revenue requirement, must be made up through end user charges.

These increases can be labeled end user charges (CALC's), authorized by the FCC or local rate increases which are out of the FCC's authority and become a matter of state regulatory policy.

Contel believes the correct and sane approach is to follow its plan for transition.

The plan (attached) deals with transferring all NTS costs from the interstate jurisdiction to the intrastate jurisdiction over a period of five years. The NTS cost recovery can, in our opinion, be dealt with more correctly by the state regulatory bodies which control the increases in local service rates.

As the attached points out, the exchange network usage plan (ENUP) meets the plan of deloading interstate toll consistent with the FCC's goal.

Contel's plan eliminates any real or practical need for the imposition of interstate end user charges.

By adoption of Contel's plan, significant and immediate rate increases can be avoided.

3. Do small and rural telephone companies have any special problems?

Contel is by no means a "small" telephone company in terms of total size.

We are, however, very rural in nature. On average, we serve 12 subscribers per single square mile. Our company demographics are as close to any "Mom and Pop" operation in the country. We believe there are special problems akin to rural companies not otherwise present in larger independents or the Bell system companies.

While some companies may have certain high cost exchanges, we have high cost companies in most of the states which we operate.

This is largely due to areas served. The connection between a central office and a subscriber residence, known as the local loop, may be one or two blocks in a metropolitan exchange, and ten to fifteen miles in a Contel exchange.

Our subscriber density and one-party penetration levels are generally lower than other telephone companies.

The small telco's have higher costs which are inherent in the geographical and demographic areas served.

The ability to raise capital for needed upgrading of existing plant facilities is more limited for small companies.

Additionally, small companies do not possess an adequate staff of experts and technicians capable of reacting immediately to opportunities.

Finally, the range of opportunities in a competitive environment is somewhat limited.

Few long distance carriers would automatically choose and target Contel's average exchanges of 950 subscribers in Missouri as places to set up a competitive location against rival AT&T. The economics of such ventures at least for the short term future, do not warrant such moves.

Without competition, stimulation in minutes of use of the network, the single most important commodity telco's have, probably won't occur.

With only one player in town and the advent of route specific toll rates, rural subscribers are not presented with the same possibilities of choice as their counterparts in metropolitan areas.

4. Is bypass a serious threat to the Universal Telephone System?

Contel believes that uneconomic bypass is a serious threat to universal service.

Uneconomic bypass will occur as long as the artificially high and discriminatory priced toll rates remain loaded with NTS costs.

Contel proposed its ENUP plan to the FCC in formal filings in Docket CC 78-72 and 80-286 (attached) regarding the planned transition of NTS costs from the interstate jurisdiction to the intrastate jurisdiction.

Under our plan, a shift of the jurisdiction allocation from interstate to state would occur over a five-year period. During this time, the "deloading" effect should be significant enough to thwart serious threats of bypass.

For all companies big and small, a relatively few individual subscribers place a significant amount of the total toll calls. Should a portion of these subscribers bypass the facilities of the local exchange company, an obvious loss in revenues would occur.

The advantage is not in the form of true economic costs but rather, a price differential afforded between two carriers providing the same type of service who, because of FCC and past separations policy, do not contribute the same level of NTS cost support.

As toll rates are deloaded of carrying the NTS cost burden, the uneconomic bypass problem should be eliminated.

Economic bypass is a reality which exists with advancing technology. Local telephone companies can only seek to avoid this type of bypass by continually enhancing the types of facilities and services they provide customers by upgrading their plant investments with state-of-the-art equipment.

Contel has undertaken a project to become 100% digital by the mid-1990's.

The use of microwave and fiber optic transmission systems is rapidly outpacing the copper plant. We now use lightguide technology as the first choice in placing a new facility. Such techniques are open to all telephone companies who can use their imagination to meet today's needs of their customers.

5. Do you have any suggestions for alternative methods of paying for a universal system?

We recommend that the current high cost factor (HCF) be adopted as the mechanism to provide assistance to telephone companies whose average loop cost exceeds the national average.

The existing plan is, in our opinion, the most objective, non-discriminatory approach to providing assistance. No further assistance is either required or desirable, since a welfare type system as proposed by some, which targets specific individual groups of subscribers rather than companies, places additional administrative burdens on both the telephone companies and the federal and state governments. This type of plan is least desirable, since the subsidies may not, in fact, end up with the subscribers who truly need the assistance.

The attached plan presented by the Contel companies to the FCC describes the lifeline service principles which are the foundation of a universal service system.

We believe that the determination of a lifeline service type subsidy is a social issue more properly dealt with at the state level. To attempt to administer this type of program on a national level would result in inequities, inefficiencies, and additional costs.

August 17, 1984

Frank M. Harlan
Vice President
Continental Telephone Co. of Mo.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
MTS and WATS Market Structure	)	CC Docket No. 78-72
	)	
Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board	)	CC Docket No. 80-286
	)	

COMMENTS OF CONTINENTAL TELECOM INC. TO THE COMMISSION AND TO THE FEDERAL-STATE JOINT BOARD

Continental Telecom Inc. ("Contel"), on behalf of all of its operating telephone subsidiaries and by its attorney, hereby submits the following comments in response to the FCC's Further Notice of Proposed Rulemaking in CC Docket No. 78-72 and CC Docket No. 80-286, FCC 84-133, released April 11, 1984, 49 Fed. Reg. 18318 (April 30, 1984). The Further Notice has requested comments on issues concerning: (1) the end user charge for residential and single line business subscribers; (2) the transition mechanism for implementing end user charges for these subscribers; (3) a lifeline exemption or other assistance for low income subscribers; and (4) additional assistance for small telephone companies. Contel's comments herein address these issues in the context of proposing substantial amendments to the separations procedures for allocating interstate service costs and investment and significant revisions in the Commission's access charge plan.

Introduction

The Commission has identified four basic policy goals to guide resolution of the issues in these now longstanding proceedings:

(1) Elimination of unreasonable discrimination and undue preferences among rates for interstate services;

(2) Efficient use of the network;

(3) Prevention of uneconomic bypass; and

(4) Preservation of universal service.[1]

Contel submits that over the protracted course of the access charge and related Joint Board decision-making process, the pursuit of these four goals in essence has reduced to a seemingly intractable conflict between two competing objectives: the advancement of interstate/interexchange carrier competition, on the one hand, and the preservation of universal service as directed by the Communications Act, on the other. More specifically, despite voluminous records of comment and numerous interim decisions, two basic issues still remain unresolved and impede the FCC's efforts to implement the system of access charges required by the MFJ:

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[1] Third Report and Order (Access Charge Order), CC Docket 78-72, 93 FCC 2d 241, para. 26, 48 Fed. Reg. 10319 (March 11, 1983), on recon. (Reconsideration Order), FCC 83-356, 48 Fed. Reg. 42987, para. 4 (September 21, 1983), on further recon. (Further Reconsideration Order), FCC 84-36, 49 Fed. Reg. 7810, para. 1, (March 2, 1984), appeal pending sub nom. NARUC v. FCC, Case No. 83-1225 (D.C. Cir.).

(1) How interstate toll should be "deloaded" in order to support the move to a competitive interexchange carrier and service market and also prevent uneconomic bypass of the local exchange; and

(2) Whether and, if so, how and when interstate flat fee end user access charges should be implemented.

With regard to the need to deload interstate toll, the nature of the problem is very clear. The past jurisdictional separations process has heavily and arbitrarily weighted the costs of the local exchange carriers' networks (i.e., distribution plant commonly referred to as non-traffic sensitive or NTS plant) to the interstate jurisdiction. At this juncture, it is not necessary to explain the original justification for the 1971 Ozark Plan, other than to observe that while it was designed to foster the public policy goal of universal service in a monopoly environment, Ozark is no longer feasible or desirable given the MFJ and the move to a competitive interexchange carrier market.

Exhibit 1, attached to these comments, indicates the effects of the past separations process for the Contel system. The interexchange carrier's (i.e., AT&T's) use of the local exchange carriers' network was in effect weighted to interstate three-fold, and with the move to interexchange carrier competition, this heavy toll loading has led to artificially high and discriminatory rates and the consequent serious threat of uneconomic bypass. In response to this set of problems, some parties to these proceedings--predictably the interexchange carriers--have advanced the notion of "Pure II" that the local exchange carrier's NTS plant was built solely for its residential and business subscribers, and that those NTS costs should therefore ultimately be charged entirely to this exchange carrier customer base. Contel and other parties have consistently answered that the exchange carriers' local distribution plant has been engineered and put into service for the use and benefit of all customers, including local exchange customers, the customers of the interexchange carriers, and those carriers themselves. The complete elimination of NTS cost recovery from the interexchange carriers through toll-deloading separations procedural changes in combination with full interstate end user access charges would certainly promote interexchange carrier competition and prevent uneconomic bypass; however, that combined action would also result in another uneconomic reaction--the interexchange carriers' use of local exchange assets free of charge and subsidized by end user local exchange subscribers to the possible detriment of universal service. In sum, while Ozark SPF has swung the cost allocative and recovery pendulum too far in one direction, the new separations procedures in combination with the ultimate thrust of the FCC's access charge plan run the real and substantial risk of swinging that pendulum too far in the opposite direction. Contel has consistently urged in pertinent legislative and regulatory proceedings that it is critical to strike an appropriate balance between toll deloading and universal service objectives.

The proposed implementation of interstate end user charges, in and of itself, has resulted in an impasse in the FCC's attempts to establish an overall system of local exchange access charges. The Commission has found it necessary to substantially revise its CALC plan from the $2.00 residential and $4.00 business minimum charges which were to have been effective January 1, 1984 as prescribed by the Access Charge Order to the $2.00 residential and $6.00 business charges represcribed by the Reconsideration Order, to the complete deferral of residential and single line business charges until June of 1985 as ordered by the most recent Further Reconsideration Order. Numerous parties have strongly opposed the very concept of residential CALCs, claiming that such charges will erode universal service values and objectives; other opponents have contended that it is unfair and improper to levy a flat rate interstate fee on the local company's subscribers regardless of whether or not they originate or receive interstate toll messages; still other critics of CALCs have argued that the FCC has improperly assumed de facto regulation of basic exchange rates. This controversy surrounding the proposed imposition of interstate end user charges has risen to the highest political order,[2] and now seriously threatens the necessary development and implementation of an interstate access charge plan with paralysis.

In light of this continuing background of controversy and uncertainty, Contel welcomes and greatly appreciates the Commission's statement in the Further Notice that while it continues to seek comment on implementation of its current access charge plan, including CALCs, it thereby does "not intend to preclude interested parties and the Joint Board from considering possible variants which will significantly decrease toll loading and serve the goals which we have established in this proceeding."[3] In response to this invitation to "re-think" the basic structure and implementation of an access charge plan and the related separations procedural changes, Contel here proposes revisions which are significant and substantial but which also would achieve a requisite balance and accommodation of the competing policy goals in these proceedings. Contel also advances these proposals with the hope and purpose that they may point the way to moving forward with an access charge plan that may enjoy a reasonable consensus of the various affected parties and interests. In brief initial summary, Contel's recommended access charge and separations plan calls for:

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[2] See, e.g., H.R. 4102 ["Universal Telephone Service Preservation Act of 1983"], 98th Cong., 1st Sess. (Passed by House November 10, 1983); S. 1660 ["Universal Telephone Service Preservation Act of 1983"], 98th Cong., 1st Sess. (1983); Letter dated January 18, 1984, from Senator Dole to FCC Chairman Fowler, signed by 31 other United States Senators, requesting, inter alia, Commission deferral of end user charges for residential and single line business customers.

(1) The replacement of the Subscriber Plant Factor formula with an Exchange Network Usage Factor formula which will reduce the NTS cost allocation to the interstate jurisdiction below the current basic gross allocator over a five-year transition period;

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[3] Further Notice, at para. 4.

(2) The adoption of the current High Cost Factor formula as the exclusive interstate support mechanism for assistance to local exchange telephone companies;

(3) The imposition of a cap on the cost amounts to be transferred to the state jurisdictions in any one year;

(4) The elimination of interstate end user access charges; and

(5) The decision that lifeline service or other direct subscriber subsidies be left to the responsibility and discretion of local exchange companies in conjunction with state regulatory and/or other governmental authorities.

I. Replacement of the Subscriber Plant Factor with an Exchange Network Usage Formula

The central element of Contel's proposed separations and carrier access charge plan is the replacement of the current basic gross allocator, based on the existing frozen Subscriber Plant Factor formula (SPF), with an Exchange Network Usage Factor (ENUF) which is equivalent to the Subscriber Line Usage (SLU) factor. Under Contel's plan, this replacement of frozen SPF with ENUF for assigning costs and revenue requirements to the interstate jurisdiction would occur over a five-year transition period. Contel further proposes that the ENUF formula be applied to all local distribution plant - local loop and Category 6 Central office

Equipment, (COE), including the "traffic sensitive" (TS) portions thereof. In this regard, Contel recommends that the weightings of the existing Dial Equipment Minutes (DEMs) factor now applied to the TS portion of the dial switch be replaced by one common formula (ENUF), non-weighted minutes of use, in recognition that advances in switching technology now undercut and will ultimately eliminate any distinction between TS and NTS COE plant. Application of a single common allocation factor will also have the salutary effect of greatly simplifying the separations process.

Contel's ENUF formula separations proposal would meet the goal which has moved in importance to the forefront of these proceedings - the deloading of interstate toll. In the new competitive environment, reversal - not merely freezing - of the Ozark/SPF cost-allocative trend is required in order to strike the proper balance between universal service and pro-competitive policy goals. ENUF would accomplish this fundamental objective in an effective and expeditious manner. At the end of the five-year transition period, implementation of this formula would allocate substantially fewer costs to the interstate jurisdiction than under the current Joint Board separations and FCC access charge plans, thereby eliminating any real or practical need for the imposition of interstate end user charges (further discussed at IV. infra). Achievement of the toll deloading goal under Contel's plan would also significantly reduce the threat of uneconomic bypass and contribute to the efficient use and service pricing of both exchange and interexchange carrier networks. Although this separations change, while deloading interstate toll, would increase state jurisdictional revenue requirements, the state jurisdictions, together with the local exchange telephone companies, would retain the responsibility and discretion to recover those state assigned costs through flexible combinations of basic local rates and access charges responsive to the particular mix of policy considerations presented in their respective jurisdictions and exchange areas (e.g., threat of uneconomic bypass, universal service needs, efficient local network use, etc.).

Contel also submits that while its proposed "Exchange Network Usage Factor" formula is identical to "Subscriber Line Usage", the recommended change in nomenclature is important in recognizing that in the post-AT&T divestiture, post-"Partnership Agreement" environment, both interexchange carriers and end subscribers are customers of the exchange telephone companies and users of their local networks, and that, accordingly, each class of exchange network customer and user should bear responsibility for the recovery of the costs of exchange network plant on a nondiscriminatory basis. Application of the usage sensitive ENUF formula in both the separations process and the interstate access charge plan provides fair and appropriate application of these "cost causative" principles.

II. Adoption and Application of the Existing High Cost Factor Formula

As part of its proposed ENUF separations and access charge plan, Contel recommends that the current High Cost Factor (HCF) be adopted as the mechanism to provide assistance to telephone companies whose average per subscriber loop costs exceed the national average. In its previously filed comments in response to the April 11, 1984 Order of the Joint Board in CC Docket No. 80-286, Contel has endorsed the currently prescribed HCF formula as the most objective, non-discriminatory approach to providing such assistance, and has also stated and supported its view that no further "small company" assistance is either required or desirable from the standpoint of overall separations and access charge goals and objectives. The cap to be imposed by Contel's ENUF plan on the costs to be transferred from the interstate to the state jurisdictions in any one year (discussed at III. infra) will also ease the local exchange revenue requirements of high cost companies and further negates any need for additional HCF-based or "small company" assistance.

Exhibit 2, attached to these comments, summarizes the impact of the proposed ENUF plan on both interexchange carriers and end user subscribers for the Contel system. Existing interstate toll loading would be significantly reduced with the interexchange carriers experiencing an overall cost reduction of 32 percent.[4] However, as indicated by attached Exhibit 3, this level of toll deloading would result in extremely heavy cost increases for residential and business customers in certain jurisdictions. Thus, for example, New Hampshire telco residential and business customers would experience increases through transition of nearly $16 per month which, when added to existing exchange rates of approximately $10 per month, could cause serious service dislocations. Contel therefore further proposes a cap on the cost amounts to be transferred from the interstate to the state jurisdictions in any one year in order to cushion this impact.

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[4] Contel notes that the HCF assistance which its predominantly rural companies and other similarly situated exchange companies would receive under its proposed plan would reduce the overall extent of toll deloading. However, on an industry-wide basis, the proposed plan's aggregate toll deloading effect would be substantial.

III. Imposition of a Cap on Cost Amounts Transferred from Interstate to State Jurisdictions in Any One Year

As an integral part of Contel's proposed plan, the revenue requirement transfer from the interstate to the state jurisdictions would be limited to $1.00 per end user subscriber per month in any one year. This recommended cap has three advantages. First, the aggregate jurisdictional transfer of revenue requirements would be substantial in each of the first four years of the transition period, thereby providing for the rapid deloading of interstate toll. Second, the potential impact on individual subscribers' basic exchange rates would be softened. And third, in those isolated instances where the total jurisdictional transfer would have a potentially severe negative impact on the continued affordability of basic exchange service, the transition period would be extended.

Attached Exhibit 4 illustrates these advantages of the proposed cap on a Contel system basis. The aggregate jurisdictional transfer in the first four years of the transition period would be $17.3 million, $34.3 million, $51.2 million, and $62.1 million, or 22 percent, 44 percent, 65 percent, and 79 percent, respectively, of the SPF-based interstate allocation. The effects of this graduated transfer would be accurately predictable for both the FCC and state regulatory authorities, thereby permitting timely and orderly planning for the recovery of the resulting revenue requirements through local exchange rate adjustments.

IV. Elimination of All Interstate End User Access Charges

Contel submits that its Exchange Network Use Factor Plan sufficiently addresses and meets the critical objective of deloading interstate toll so that there is no real or pragmatic reason for the imposition of interstate residential, single line business or multiline business end user access charges. With the elimination of interstate CALCs, the most controversial element impeding the establishment of the needed Federal interstate access charge plan is removed. Although Contel has accepted the initial implementation of interstate end user charges, it has maintained that the present plan, through transition, would be significantly slanted towards benefitting the "interexchange" carriers' customers while unduly discriminating against the local exchange carriers' customers. It is now evident that an alternative mechanism and plan for deloading toll and preventing uneconomic bypass while responding to universal service concerns is required.

In proposing its alternative ENUF plan, Contel recognizes that the FCC has previously found that "flat fee end user charges are an equitable and economically sound method for recovering a portion of NTS costs."[5] Contel submits that such a flat end user fee method of cost recovery is already implicit in the basic exchange rates of the local exchange carriers,[6] and that the ENUF formula, which should be mirrored in state rate adjustments, will result in the continued recovery of the shifted jurisdictional costs according to that principle. Measured against universal service values, however, there is no reason to go beyond the ENUF plan to charge more NTS costs to end users through interstate CALCs when that plan will sufficiently deload interstate toll.[7]

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[5] Further Notice, at para. 4.

[6] The CALC has been regarded by some as the fee to be connected to the interstate network. However, to date it has not been technologically feasible not to connect an exchange customer to any one of the four possible networks--exchange, intralata, intrastate-interlata and interstate. When an exchange customer receives service, that customer receives access to all four. In the past, the exchange rate has been in essence the "fee" for being connected to all possible public switched networks. The new issue has not been how to devise an additional duplicate charge, such as the CALC, but how to reverse the unreasonably increasing SPF-based contribution which toll services make to that connection fee.

[7] The Commission's current access charge plan, as would be implemented through 1989, would continue to recover a significant portion of interstate NTS costs through usage-based Carrier Common Line Charges. In this respect, the Commission's own plan appears to recognize that the real and critical policy concern in these proceedings is the deloading

(footnote continued)

V. Lifeline Service Principles and Responsibilities

Contel believes that a proper distinction should be drawn between universal service and lifeline service. Generally, proposals to ensure "universal service" require additional support to high cost exchange carriers having high cost loops, with the the additional revenues directed toward meeting, to a certain degree, that carrier's revenue requirement so that basic local rates for all subscribers served by that carrier can be maintained at a lower level thereby maintaining an optimum customer base which is to the benefit of both local and interexchange carriers. On the other hand, "lifeline service" involves the awarding of a subsidy to a specific class of customers within the general body of ratepayers and is comparable to a social welfare plan. Under the universal service high cost factor, carriers must meet certain requirements to obtain assistance, whereas lifeline subsidy would presumably place qualification requirements on specific individuals. Accordingly, Contel believes that the determination of a lifeline service-type subsidy is a social issue more properly dealt with at the state level. To attempt to administer this type program on the national level would result in inequities,

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of interstate toll costs and not the reduction or elimination of usage-based recovery of the remaining costs *per se*.

inefficiencies, and additional costs. The extent, application and source of lifeline service should therefore be administered and funded at the local (state) level.

Lifeline service must be strictly controlled and subsidies awarded on the basis of proven need. Standards must be drawn that are administrable, lawful, and subject to usage evaluation.

The exchange carriers furnishing lifeline service should recover the full cost of that service and should not be expected to fund any differentials.

VI. Contel's Proposed Plan Best Serves the Four Basic Policy Goals of These Proceedings.

1. The plan would work to eliminate unjust discrimination or unlawful preferential rates.

The adoption of the Exchange Network Usage Formula would accomplish the Commission's oft-stated goal of eliminating unjust discrimination and unlawful preferential rates. The formula would remove the arbitrary weightings which have assigned a disproportionate share of the local exchange carriers' revenue requirements to the interstate jurisdiction and would in a very timely manner significantly reduce interstate carriers' access charges. At the same time, the formula would provide that all users of the local exchange carriers' networks would pay for such use in a nondiscriminatory manner. Further, the plan would reject the inequity of free use of the local loop by interexchange carriers subsidized by the residential and business customers of the local exchange carriers.

2. The plan would encourage network efficiency.

Contel's proposal would eliminate the artificially inflated assignment of service and investment to the interstate jurisdiction and the resulting unreasonable level of cost burden which is presently placed upon toll services and interexchange carriers. By considerably reducing the contribution that the local exchange companies currently receive, this plan will strongly encourage network efficiency both at the local exchange company level and in the interexchange market. After transition, interexchange carriers and end users will be placed on an equal footing, thereby providing necessary and appropriate incentives for local exchange companies, as well as interexchange carriers, to actively support and promote growth in the interstate toll market. This impetus would represent a great improvement over the present access charge plan which after transition places an unbalanced burden on residential and business customers, provides little incentive to exchange carriers, and fails to recognize the fundamental reality that joint and common local distribution plant plays a vital role in the furtherance of the interstate toll business.

3. The plan will discourage uneconomic bypass.

By quickly deloading interstate toll and annually and significantly reducing interexchange carrier charges, the Contel plan will effectively counter the threat of uneconomic bypass. In addition, the plan will give telephone companies the ability to respond competitively to potential bypass with flexible pricing alternatives to end user charges. Without this flexibility in a free market environment, uneconomic bypass may be inevitable.

4. The plan will meet universal service objectives.

Contel's plan will help assure the continuation of universal service. The plan provides for a predictable transition reduction in the interstate allocation of NTS plant and therefore significantly mitigates any adverse effects on universal service. The $1.00 per customer per month cap on the amount jurisdictionally transferred in any one year provides a gradual transition in which severe cost and rate impacts will be mitigated over time. The elimination of the interstate end user charges will permit the local exchange companies and state regulatory authorities to deal more effectively and equitably with the particular circumstances and policy imperatives which may exist at the state and local exchange area levels. The incorporation of the currently prescribed High Cost Factor will flow additional assistance to those companies whose exchange loop costs exceed the national average.

CONCLUSION

Contel respectfully proposes its separations and carrier access charge plan as an alternative which will better balance and accommodate the competing policy goals in these proceedings as well as move this critical decision-making process to a viable and final conclusion. Contel therefore respectfully requests that the Federal-State Joint Board recommend and the Federal Communications Commission adopt separations procedure revisions and access charge plan modifications in accordance with these comments.

Respectfully submitted,

CONTINENTAL TELECOM INC.

By:
James E. Graf II

Its Attorney
Weil, Gotshal & Manges
1101 Fourteenth Street, N.W.
Washington, D.C. 20005

May 21, 1984

Attachments - Exhibits 1-4, five pages

Mr. WYDEN. Mr. Buchanan.

TESTIMONY OF WALDO BUCHANAN, PRESIDENT, EASTERN MISSOURI TELEPHONE CO.

Mr. BUCHANAN. Mr. Chairman, members of the committee.

My name is Waldo Buchanan. If I do not stutter, it will take me 4 minutes and 15 seconds to read this.

I am president and general manager of a small independent telephone company, Eastern Missouri Telephone.

The company serves parts of five northeast Missouri counties, with approximately 2,400 access lines and 3,500 telephones.

I have been active in the telephone business for over 40 years. I would like to read a brief statement we have already prepared for you, and my perspective will be that of a very small telephone company manager of rural America.

In my opinion, the telephone industry is in something of a state of shock due to the agitated transition we presently find ourselves in. This transition, of course, was caused by the advent of competition into the industry and divestiture. These two major structural changes in the industry have, in turn, caused any number of developments to occur to which answers must be found, and I will only touch on one or two.

This phenomenon of bypass is draining toll revenues from operating toll carriers which, in turn, will impact revenue divisions with local exchange carriers, if it already has not done so. This will, in turn, create upward pressure on local and long-distance rates. One solution that has occurred to me is to have the FCC license all bypassers and license them heavily.

End user charges and universal service. Another solution to bypass is end user charges. One of the tenets of the telephone industry for 50 years or so has been universal telephone service. End user charges work in opposition to universal service. Policymakers have continued to give lipservice to universal service but, in actuality, have been advocating policy such as cost causer pays. This would be detrimental to universal service.

"Cost causer pays" and "universal service" are not compatible terms. A decision must be made whether we are to continue to have universal service. If we are to continue this philosophy, then a subsidy of some sort is necessary. Licensing of bypasses is one method. Another method would be to make all interexchange carriers pay more equal exchange access charge.

It is my understanding moves are under way to resolve the bypass issue and retain universal service. The details, to my knowledge, have not been worked out.

There have been numerous cases of various types of enterprises invading an exchange carrier's franchise area to serve heavy toll users or lucrative portions of an exchange such as large airports. If allowed, this will place additional upward pressure on local rates. It seems to me the appropriate regulatory bodies, with the backing of the courts and Congress, if necessary, could solve this problem by reaffirming exchange carrier territorial integrity.

The telephone industry has many other pressing problems, all of which are being addressed by leaders of the industry and related organizations. Solutions to them must be found quickly.

I am continually asked two questions by people outside of the industry. One is, is all this turmoil and change taking place in the telephone industry beneficial to the general public? My answer is on a long-term basis, hopefully.

The second question, will or can the industry be put back like it was? The answer is, it cannot be, too much has happened.

We must find a way to go forward from here.

Thank you.

Mr. WYDEN. Thank you very much.

Mr. Skelton.

Mr. SKELTON. Just a couple questions, Mr. Cashwell. You mentioned that bypass is already affecting your company, and this is basically rural Midwest, is that correct?

Mr. CASHWELL. The majority of my customers are rural.

Mr. SKELTON. Would you tell me or give me some examples of what is eating into your customers in the bypass system, what bypass users are there?

Mr. CASHWELL. Specifically, TWA is bypassing us. Missouri Power & Electric, I believe it is, is bypassing us, and Kansas Power & Electric is bypassing us.

Mr. SKELTON. Missouri Public Service you mean?

Mr. CASHWELL. I mean Missouri Public Service.

It is my understanding that all three of them have told us that the reason they are bypassing us is because the price of the service.

Mr. SKELTON. They are able to get it cheaper?

Mr. CASHWELL. They were apparently able to put in their own, apparently, lease, rent, or do something that lowers their telephone bill.

Mr. SKELTON. Your comment to the effect that the cost causer pays system is not compatible with universal service. How many of us here agree with that statement, raise your hands.

Mr. CASHWELL. Would you repeat the question?

Mr. SKELTON. Cost causer pays is not compatible with universal service, how many agree with that concept?

Mr. McArton does, Mr. Fisher does.

Mr. Caldwell.

Mr. CALDWELL. I would have to have more of a definition of what you mean. I do think that if we price on our cost that there would be people who could not afford it, but I think if you do not price on your cost you would also have the demise of universal service. Some action may be necessary to be taken.

Mr. SKELTON. Mr. Cashwell.

Mr. CASHWELL. I would share Mr. Caldwell's view in that you need to go toward cost causer; but if you went 100 percent of the way, there is no doubt in my mind we would lose a lot of my customers.

Mr. SKELTON. Thank you.

Mr. Copsey.

Mr. COPSEY. I agree with the statement.

Mr. SKELTON. Mr. McClelland.

Mr. MCCLELLAND. I agree with Mr. Buchanan.

Mr. **Skelton**. Mr. Harlan.

Mr. **Harlan**. Yes.

Mr. **Skelton**. Mr. Buchanan, do you agree with what you say?

Mr. **Buchanan**. I agree with what I say.

Mr. **Skelton**. What we lack is consistency.

Do you have a comment, Mr. Harlan?

Mr. **Harlan**. I just wanted to say you have to progress toward it as far as you can. If you go all the way, then, yes, it does affect you.

Mr. **Skelton**. I was going to ask one further question, but the last response has already answered it.

Thank you very much.

Mr. **Wyden**. To start with Mr. Cashwell and Mr. Caldwell, the access charges are going to shift a very large amount of money, probably about $11 billion, in long-distance to local charges. The $11 billion is part of the $40 billion of non-traffic-sensitive costs. The first thing that we would like to ask of you would be to provide to the task force a detailed breakdown of your non-traffic-sensitive costs, the elements in your non-traffic-sensitive costs, and we would like that of both of your companies.

Mr. **Skelton**. Our record will be held open 30 days, I believe.

Mr. **Wyden**. We will leave our record open 30 days. We would like it in 30 days, and we will work with you, and this is not to put any time constraints on you, but we will keep it open 30 days and we need it to really make our recommendations on November 30. We have just got to get a handle on the non-traffic-sensitive costs because if there are ever to be any other alternatives, we have got to figure out how to allocate this money.

Mr. **Youngworth**. Would you have any objections if some of we smaller companies gave you that?

Mr. **Wyden**. I would be honored.

Mr. **Youngworth**. You've got it.

Mr. **Wyden**. Can we have that from all of you?

Mr. **Harlan**. Yes. This is basically what I gave you, although I could put it down in a formula where you can understand it, but this is exactly what I did; yes.

Mr. **Wyden**. You painted a very scary picture. I hope that is not going to be representative of the rest of the country, a 200-percent-plus increase for the small businesses.

Mr. Caldwell, you mentioned that 21 of your largest customers were engaged in bypass at this time, and it is my understanding essentially you all have really been the only ones to look through this bypass issue, that there had been a study done by Southwestern Bell and was given to us last year, and my understanding was that the principal finding was that costs were involved in bypass, but the primary thing you found is that people bypass for service reasons rather than cost. Would you be able to elaborate a little bit on that?

Mr. **Caldwell**. Yes. First of all, the 21 number you mentioned a minute ago was percent of our large business customers and not total number of customers.

Mr. **Wyden**. Twenty-one percent of your customers now?

Mr. **Caldwell**. Yes; of our large business customers are engaged in some form of bypass. This was from a study done by Touche, Ross & Co. and was an issue in our divestiture rate case here in Missouri and the prior record in our case. The gentleman who conducted the study for Touche, Ross was a witness in this case and testified as to this issue.

Mr. **Wyden**. They are bypassing now?

Mr. **Caldwell**. Yes.

Mr. **Wyden**. Twenty percent of your customers?

Mr. **Caldwell**. Twenty-one percent of our large business customers based on this survey that he made.

Mr. **Wyden**. Is that local or long distance?

Mr. **Caldwell**. Both.

Mr. **Wyden**. If you could get us one of those and save us a little time on that, that would be helpful.

Mr. **Caldwell**. OK.

Second, the study does not say that the primary reason is service. It says the primary reason is the cost by a wide majority. I do not remember the percentage, but the overwhelming reason for bypassing this study was the cost and not the service or not other reasons either, although they are also a factor sometimes.

Mr. **Wyden**. Is that not at odds with your own study, then?

Mr. **Caldwell**. No, this is the study that I was referring to. The company has conducted a bypass study of its own since that time. I am not real familiar with that study since it has just now come into fruition.

Mr. **Wyden**. So the second study is not in synch with the first one?

Mr. **Caldwell**. Basically it is. The second study also says that cost is the reason. We have a report that the chairman of the commission mentioned where they want to monitor bypass in this State, and so we are making a report on a regular basis to our commission about bypass. The first report was due just the other day. We had a relatively short period of time since the order to put this report together.

I might also, before I say any more, say that it is very difficult to get real specific about every single bypass case because the people doing the bypass are not that anxious to communicate with you about the bypassing so we have to stumble into these in many cases.

Mr. **Wyden**. I would agree with that, and I would like to see the second study as well because the first study was clear that, while they both were a factor, service was ahead of cost, and I read that summary and remember it.

Tell me who the biggest potential bypassers are.

Mr. **Caldwell**. I want to be sure I clear up something in the comment you just made. The study that you are thinking about was not made by Southwestern Bell. We have not made any study of bypass that indicates that the primary reason is anything but cost. There is no such study made by Southwestern Bell or by Touche, Ross. There may have been another study somewhere else that you have read. I remember reading a similar study of businesses somewhere else and not just Southwestern Bell.

Mr. **Wyden**. It was circulated quite widely on the Commerce Committee last year.

Mr. CALDWELL. I will be glad to doublecheck, but to my knowledge there is not one. To answer your question, what kind of customers, this report that we just turned in to the commission, who bypasses?

Mr. WYDEN. Who are the potential biggest bypassers of your customers?

Mr. CALDWELL. I can give you ones that are bypassing, the type of people who are bypassing now. The report we just turned in shows a revenue loss to Southwestern Bell of these that we have just come up in a short period of time of $5.4 million in lost revenue in Missouri because of bypass, and the type of companies range from major newspapers to public utilities, to the Government, various Federal and State governments, large manufacturing concerns. There is a cross-section of bypass type of businesses. They are not concentrated in any one particular area.

Mr. SKELTON. Gentlemen, just a point. Out of curiosity, what is the smallest type of business that bypasses?

Mr. CASHWELL. We had one this morning, the lady that represented MUZAK apparently was representing herself as small business, and she mentioned some things that were definitely bypass and indicated that they were bypassing the local network in several cases, and that is just an example of one type.

Mr. SKELTON. You can go pretty small?

Mr. CASHWELL. That is right, very small.

Mr. CALDWELL. We are concentrating our efforts in identifying these bypassers initially on the bigger customers because of the loss of revenue. The answer I started to give you is that almost any small business, particularly one who has relatively large long-distance calls, are potentially a bypasser; but even more than that, every residential customer is a potential bypasser.

Mr. WYDEN. I think that that is just an incredible notion. You said that every residential customer is a potential bypasser. In my district, people are at the point now where they cannot afford their phone and they are going to a community phone. Senior citizens are not potential bypassers.

Mr. CALDWELL. I do not want to argue with you but I can give you an example of what I am talking about. You can have a high-rise housing addition or a neighborhood, and someone who is in the business of providing long-distance services can go directly to that neighborhood or directly to that building and put a microwave disk on the building and carry all the long distance that those people want to make directly to MCI or AT&T or SPRINT or anybody else and bypass the local network so they do not have to pay long-distance rates.

Mr. WYDEN. I accept that, and there is no question that retirement homes and big complexes of the elderly and the like have that potential, but you said every residential user has a potential to be a bypasser, and I can just assure you there is no way on earth that that is the case because there are millions of senior citizens and handicapped people who are just barely able to keep their phones at this point based on what we are hearing.

Mr. CALDWELL. It is not that they would be paying any more money. I mean I think you are inferring that they would have to pay a lot of money. I recognize that that end of the thing is not an immediate threat, but eventually every neighborhood could be worthwhile to the long-distance companies.

Mr. **Wyden**. You said residences?

Mr. **Caldwell**. Yes.

Mr. **Wyden**. You said residences were going to be bypassers and now on to neighborhoods and high-rise complexes and the like; and there is no question that once you assemble into a unit, be it a complex or any group of a significant size number, then I would agree with you there. That is quite a far cry from every residence.

Mr. **Caldwell**. In addition to that, you have the potential of cable television carrying telephone service.

Mr. **Cashwell**. Could I speak to the bypass just a moment?

Mr. **Wyden**. I think I interrupted Mr. Skelton.

Mr. **Skelton**. No, no. You answered my question.

Mr. **Cashwell**. I mentioned earlier that my average density of customer in Kansas is eight per square mile. Wednesday's paper from the "Kansas City Times" has an article, "State-Owned Phone System Study" in which it starts out by saying the State now has a $15 million annual telephone bill and they are looking into the possibility of establishing their own network. If that $15 million, some portion of which flows to us—I am not sure, but a great portion of it flows into the NECA pool that is presently supporting the non-traffic-sensitive plant for the State of Kansas, there is no question in my mind that the ratepayers in Kansas are going to feel some effect of that.

Mr. **Wyden**. Understand that we are very much in agreement with the proposition that bypass is real, is substantial. I happen to think that much of it, which is what our last panel dealt on, is not taking business from anybody. It is new technology, new innovations, and they are coming in the market and they are not taking business from anybody.

Mr. **Cashwell**. Would you say that would be true there?

Mr. **Wyden**. If I might just go on, the States clearly are today engaged in areas that are competitive with existing kinds of systems, so we agree with you that bypass is an issue. The question is, Are we going to let this be the tail that wags the dog. Are we going to just swallow this bypass bugaboo which, if you do, locks us into access charges basically for all time? As far as I can tell, is that if you accept the thesis that bypass is moving this whole system, you are on with access charges forever and a day, and then I think you see some of the consequences that the gentlemen down here at the end of the table were touching on.

One other question for you, Mr. Caldwell.

Would Southwestern Bell like to go to mandatory measured service for business customers?

Mr. **Caldwell**. No. Southwestern Bell believes in measured service but it is our policy and belief that the best way to provide measured service is on an option basis so that the customer chooses. We think as time goes on measured service will make more and more sense to businesses, and I guess the percentages will increase of those on measured business; but as far as we are concerned, our policy is to have an option where they have both flat rate and measured service available.

Mr. WYDEN. Do you see it that way pretty much on the residence side, keep it as an option, and your thesis is that people are going to start liking it and they will do it optionally?

Mr. CALDWELL. They are starting to like it. We have local measured service in Missouri and it is growing rapidly. The customer base is growing both in residence and in business, so I agree with your statement.

Mr. WYDEN. One last question. Everybody that we have talked to in the business says that, Congressmen, we have got to stop subsidizing those millionaires, retirement homes in the California mountains and we have got to structure this thing so that we take care of the needy. The answers wherever we go in the country are almost the same, they are almost all from people of good will and are committed to the universal service, I think. Then they say, well, set up a welfare system, fellows, that will do it. You heard me say—I think most of you have been here—that I do not think it can be done. I do not think we can run a two-class phone system in this country. I have been very active in this area for many years with senior citizens. The whole track record is that you do not get the help to people who need it the most and you probably get it to a fair number who do not necessarily need it. I do not think it can be done.

Now, almost every one of you here today, like everyone else around the country of good will and reasonableness, is saying do this, set up some kind of welfare arrangement. Do any of you have any ideas on how this ought to be done? Have you talked to the senior citizens in your area, or do you have any kind of counsel for us on how to do it because we are here to listen? We like the idea. As I said, I would be willing to entertain just about anything that has a prospect of working, but I can guarantee you that phone stamps are going to be a must, and they are not going to work.

Mr. CASHWELL. We have done some preliminary work in a couple of States in trying to help put together maybe some sort of plan that would tie in with a life line service or some program that maybe the State legislature would adopt that would recognize that there are some low-income people who really cannot pay the non-traffic-sensitive cost of their plant. I am sure we would be happy to send that information to you if you think it would be helpful.

Mr. WYDEN. It would. Nobody wants to subsidize the wrong people. There is no loud cheering for that.

I think what the debate comes down to are two tough problems. You have a choice of trying to tag the bypassers and in some way bringing them into the system, particularly when they hook into the local loop; or to go out and try to set up a welfare state and run a two-class system. I think they are both very complicated and tough things to do. I think we have more of a chance to tag the bypassers myself, which is what the FCC has essentially started to do, than we have a chance of going out and setting up a giant welfare system and then somehow targeting these subsidies but I am not fixated on this.

Mr. CALDWELL. We, in Missouri, have a consumer panel group of people outside of our business that we talk to about things like this who represent consumer groups and Farm Bureau and a diversity of opinions like that, and we have talked about this. You asked the question of whether we have talked to consumers about universal service funds and that kind of thing, and we have done that.

First of all, it is our opinion that the telephone companies should provide or should have in their services a low-cost type of service, an option that is affordable. In our instance, local measured service is an example of a service like that, which is much less expensive than to allow someone to control their own costs.

Second, if we did have a universal service fund that was targeted to individual people, then it is the consumer panel, and I think, my personal opinion, that it could be administered on a local level better than any other way. We have some examples of that that I am aware of in the electric industries in St. Louis where local people are distributing a universal service type of a fund for electric rates.

Finally, I cannot help but comment on your discussion or your concerns about a two-class system. I, too, am worried about a two-class system. But my vision of a two-class system is one where people with a lot of resources, big businesses and up-scale type residence customers and people like that, have the wherewithal to leave the network, make the capital investment to have high technology and state of the art type of telecommunications and leave behind for the local network those who cannot afford to do that, so that the local network not only loses that contribution but this vicious cycle I talked about starts in, and the local network becomes lower and lower technology with fewer and fewer of the people and the ones least able to pay the cost left behind. That is my vision of a two-class system of a telecommunications system, and I think that is a real danger in our country today, and if we do not make the right decisions about pricing, then I see that happening. I share your concern but I see a different way of solving the problem than you do.

Mr. WYDEN. I think that is a very thoughtful analysis of that point of view. I guess the answer is that, given the two, we see today that the FCC is putting in place some systems to try to deal with the bypasser. We do not have anybody yet who has a concrete plan to set up some kind of system to target subsidies to the low-income and elderly. So what we are searching for is some kind of middle road. We want to make sure we do not freeze technology. Nobody is in favor of that.

We do want to make sure that when we are targeting resources that we do the best job that we possibly can. As of today, getting the bypassers in the system looks more doable than setting up another welfare network type of system for low-income people. So, in a sense, this one is in your court as well as ours, is that you would like us to carry the day on this point of view. To do it, we need some concrete, practical ways that we could have systems to target subsidies, give assistance only to those people who need it. And there are not many defenders in the Congress of well-to-do people getting unnecessary subsidies at a time of huge deficits and rising costs.

[Mr. Buchanan's prepared statement follows:]

PREPARED STATEMENT OF WALDO BUCHANAN, PRESIDENT, EASTERN MISSOURI TELEPHONE CO.

My name is Waldo Buchanan of Bowling Green, Missouri. I'm President-General Manager of a small rural telephone company serving approximately 2,400 access lines and about 3,500 telephones, over parts of five northeast Missouri counties. I have been active in the telephone industry for forty years. I would like to thank you gentlemen for allowing me the opportunity to address you.

Let me preface the remarks I make by telling you I am not an expert on anything regarding the telephone industry, and don't claim to be. Also, there must be a great deal about what's happening in the industry that I don't understand because a lot of it doesn't make too much sense to me.

Over the past six to eight years, I have watched and been involved in a small way in the momentous changes that have been and are taking place in the telecommunications industry. I am frankly concerned about the future of the industry and particularly worried about the future of the small independent companies that mostly serve small towns and rural America. It is my understanding that the littler independents serve only a small percentage of the total telephones in the nation, but this percentage represents over six million establishments, and perhaps as many as twelve million people. These are people young and old, sick and healthy, and each of them needs access to good dependable telephone service. When examining situations of this kind, I tend to shy away from using percentages.

In my opinion the telecommunications industry, right or wrong, has been so drastically changed in the recent past that there is no way it can be put back like it was. We must go forward from here, but we must do so carefully. The industry is in a state of shock -- at least that part of it I'm associated with is. It needs guidelines by which to operate, and answers now to many questions. It's like an army that's advanced too far too fast and must stop to consolidate its position. The telecommunications industry too must take time to examine its position, its condition. It must re-examine its goals, perhaps redefine them, and attempt to proceed with a proper sense of perspective. There is too much confusion, too many unknowns, for the industry to be able to continue to function effectively.

A few examples of why I say these things follow:

1. Universal service has been one of the tenets of the industry in the past -- can it be preserved?
2. "Bypass" is presenting a major problem -- can an answer be found?
3. The controversy over "End User Charges" must be solved.
4. An equitable division of revenue must be worked out.
5. Exchange integrity (or who is to serve what) must be established.
6. The problem of service responsibility (or who takes care of what circuit of what plant) must be refined.
7. The problem of equipment compatibility (or who is responsible for equipment standards) must be answered ----

and the list goes on. All of these items and others are being addressed by the industry and related organizations, and progress is being made on the solution of some. However, the answers to others seem more elusive. Let's examine some of these.

Presuming that one of our goals is universal service, or good service to all, at reasonable rates, the question arises "Will the policies being established for the industry promote universal service?" Until very recently, my answer would have had to be "No." It has seemed to me, until very recently, some of those persons and organizations making industry policy were giving lip service to the idea of universal service, but were at the same time advocating plans and policies that would make it impossible to implement. The philosophies of "cost causer pays" and "universal service" are simply not compatible. They are contrary ideas. In rural or sparsely settled areas, actual cost of service (cost causer pays) can be very expensive. The high per station investment guarantees this. Thus, if the industry is forced to operate under the philosophy of "cost causer pays the full cost", universal service cannot be viable in these areas. A decision with social overtones must be made: Shall the industry partially subsidize monthly telephone rates, and thereby preserve universal service -- or shall it operate under the idea of "cost causer pays" and eliminate universal service? To the credit of some of our industry leaders, this problem is being attacked with the idea of a universal service fund. I am not aware of the details being worked out, but am confident this can be done, and universal service retained. It is an item to be watched.

Another problem of major concern is what to do about "bypass." "Bypass" brings up the controversial idea of end user charges, and also spills over into universal service. "Bypass" is a very real and growing issue. A number of large corporations and even some states have either already installed their own communications systems or are planning to do so. Within the last several weeks, I have examined a study the state of Missouri has worked up in this regard. I am told Oregon, California, and other states are also developing communications system plans. In view of the rapid pace "Bypass" is growing, and the loss of toll revenue this will cause, the telecommunications industry must act quickly to devise a strategy that will discourage it. One method suggested is "End User Charges." I have trouble with this plan, as it suggests the industry place a monthly charge on each subscriber's bill. Various amounts have been suggested, but to me we are placing the burden of cost on the wrong group. "Bypass" is being caused by large corporations and organizations trying to reduce their long distance costs by building their own communications systems, and bypassing the toll network.

It is my understanding the reason these organizations can do this is because long distance rates are set high, by inter-exchange carriers, in order to subsidize other segments of the telecommunications industry. This makes it economically feasible for bypassers to exist. The idea of an end user charge, then, is to allow the inter-exchange carriers to reduce their long distance rates, which in turn would make bypass less desirable to toll users. The end user charge would help make up the loss of toll revenue to the local exchange company. But why are we penalizing the local exchange subscriber by having them make up lost toll caused by big corporations and organizations who wish to lower their operating cost by going the bypass route? To me, it would be a much more equitable and simpler matter to heavily license, through the FCC, all "Bypassers." The money derived from bypass licensing would be used to replace end user charges. Applying this method, we would be charging the cost causer, which is the policy being advocated; we would be helping preserve universal service, which is what most persons seem to feel should be done; and we would not be placing an inequitable charge on local subscribers. One argument against licensing "Bypassers" is that the FCC couldn't possibly administer such a program. However, the FCC has administered a much larger, similar program for years, by licensing two-way radio. It's very doubtful bypass users would ever approach the number of two-way radio systems now operating, especially if a licensing arrangement is placed in effect. A second argument in opposition to this idea is that it would cause a slow-down in the development of new communications technology. This argument is perhaps valid to a point, but I doubt this policy would have a major effect on new communications technology development, and perhaps wouldn't affect it at all. Thus, I would suggest the licensing by the FCC of all "Bypass" operators as a possible solution to this problem.

Another method of eliminating or reducing an end user charge is to charge all inter-exchange carriers an access fee for accessing local exchange facilities. Again, we are simply charging the cost causer. The revenue obtained, along with the revenues from the bypass licensing, could all go to alleviate any need for an end user charge, or reduce it to a very nominal one.

Another major problem surfacing is that of exchange integrity. Local telephone companies, large and small, have hundreds of millions of dollars invested in local plant to serve specifically defined areas. To allow others to pick certain lucrative parts of these areas to serve, such as major airports, large apartment complexes, or other things of that nature, will simply drain revenues from the local operating company. This in turn will cause upward pressure on rates, again affecting universal service, and in some cases would be extremely detrimental to the local companies' financial stability. It would seem that in view of all of the other major upheavals taking place in the industry, this is one that could easily be settled for the present, or in effect be put off until the industry has time to digest the other changes. Teritory integrity should be reaffirmed by the appropriate regulatory bodies, with hopefully the support of the Courts if necessary. This would answer the question of exchange integrity, at least for the time being.

In summary, I have attempted to point out the telecommunications industry is involved in something of an agitated state of transition. This situation has been caused by a number of factors, some of which I have listed:

1. Concern over the continued viability of universal service;
2. Problems caused by the advent of "Bypass";
3. The controversy over end user charges, and how to solve it;
4. The concern regarding an equitable division of revenue within the industry;
5. The worry regarding the erosion of exchange integrity;
6. Operational problems within the network caused by not knowing who is responsible for the maintaining of what;
7. The possibility of major future operational problems, due to a lack of compatibility of equipment (this being because the industry standards formerly set by Western Electric may no longer exist).

Answers and solutions must be found for each of these items. Some of these answers were needed yesterday, a few are needed today, but none of them can wait for a distant tomorrow. I know the telecommunications industry to be staffed with dedicated, industrious individuals of the highest integrity. I also know many of them are focusing their full attention on these problems. These leaders, in collaboration with various regulatory bodies involved, members of Congress, and others, will find reasonable conclusions to the problems facing the industry today. I am confident our industry will, within a few years, again be looked upon with envy by the rest of the world, as it offers the world's finest communications system known to the nation it serves. Meanwhile, we must all co-operate and work to solve the problems that are keeping us from attaining this goal.

Mr. **Wyden**. Mr. Skelton.

Mr. **Skelton**. I have no further questions, but I would like to take just a minute and thank you, Congressman Wyden, for coming here to Missouri and listening to our folks and all of their varied thoughts and suggestions. This is a very complex issue. I appreciate Congressman Wyden taking the time to share his expertise on this important issue and to get more from us here in Missouri.

We have a long way to go before we come to any conclusions on this. I hope that in the days ahead as recommendations are made, as debate will unfold undoubtedly within the Congress, I hope that you will feel free to stay in touch with, if I am your Congressman, with me, or with others who might represent you because I think this is going to be, as the Congressman said earlier, one of the major issues of this decade—continuing universal telephone service at a moderate price for everyone.

Thank you again for coming. It is a terribly complex issue. You have assisted us immeasurably. We still have much to learn before we reach any conclusions, but you have helped us to make this wonderful thing called democracy work a little bit better by your presence.

Thank you so much.

Mr. **Wyden**. Let me also say before you run off that I think you have an added incentive to be at the drawing board and work with us on new proposals because you have leadership like Ike Skelton on the Small Business Committee.

You know, he did not have to spend his August recess trying to set up this hearing so he could listen to small businesses and to phone companies and to consumers and the like.

As I said earlier, this is an area where we are in search of fertile minds. No question about it, the world has changed dramatically. What we want to do in Government is not dam up the forces in the private sector, but we want to figure out a way to liberate them, to open them up and serve the people. You can help us do it, and we thank you all for a very, very helpful hearing.

With that, we are adjourned.

[Whereupon, at 1:45 p.m., the task force adjourned, to reconvene subject to call of the Chair.]

APPENDICES

APPENDIX A

John F. Parkhurst
Vice President

925 L Street, Suite 850
Sacramento, California 95814
(916) 325-7941
(415) 542-4181

PACIFIC TELESIS
Group

September 21, 1984

The Honorable R. Wyden
1406 Longworth Building
Washington, D.C. 20515

Dear Congressman Wyden:

On behalf of Pacific Bell, I would like to thank you for the opportunity to participate in the House Committee on Small Business hearings recently held in Seattle Washington. During those hearings Pacific was asked to comment on an article comparing Oregon and California Local Measured Service rates and charges for the "Hunting" option.

Following is a summary of our findings:

A. Current Rates for Business Access in Pacific (effective 7-1-84)

Measured Service		$8.25/Mo
Flat Service (available only in non-measured areas)		17.15/Mo*
Local Usage	initial minute	- .04¢
(within 8 miles)	additional minute	- .01¢
10 minute Zone 1 call		.13¢
Hunting		.50¢/line/Mo
Line Conditioning		no charge

* This charge may be higher in exchanges with Extended Area Service.

B. Pacific estimates the cost of hunting to be about 35¢/line/mo when served out of an Electronic Switching System (ESS) office and slightly higher when served from older equipment. It would appear that Oregon has chosen "hunting" as a value-added service. Such services are priced higher than cost to subsidize other services offered by local telephone operating companies.

C. Measured service is mandatory for Pacific businesses in areas where measuring capacity exists. It remains an option for residential subscribers where available.

I would like to take this opportunity to clarify certain numbers submitted in our written testimony. The LMS costs submitted were 1986 expected costs. The 1984 costs are:

	1st min	add min
Unlimited Local Service	4.0¢	1.2¢
Local Measured Service	4.7¢	1.2¢

Pacific would like to continue to share our experience in this area with your Committee. As issues arise, please feel free to contact me, or Hal Boel, Vice President - Federal Relations, in our Washington office. We will be happy to arrange meetings in Washington, at your convenience, with appropriate Company experts.

Sincerely,

APPENDIX B

United Telephone System

UNITED TELEPHONE SYSTEM — MIDWEST GROUP
6666 WEST 110TH STREET/OVERLAND PARK, KANSAS 66211/(913) 383-7900

R. B. CASHWELL
President

September 24, 1984

The Honorable Ron Wyden
House of Representatives
1406 Longworth House Office Building
Washington, D.C. 20513

Dear Sir:

Pursuant to your request on August 24, 1984, at the Small Business Committee's Telephone Task Force Field Hearing in Kansas City, please find attached: (a) an analysis of non-traffic sensitive (NTS) costs for two of our states, Kansas and Missouri; and (b) a draft bill regarding a Basic Local Service Assistance Program (BLSAP) in Iowa, along with comments which we filed with the Minnesota Public Utilities Commission regarding the same.

As is witnessed by the above referenced analysis, our total monthly non-traffic sensitive revenue requirement in Kansas is $24.25 and in Missouri $25.31. Currently 78% of the Kansas non-traffic sensitive costs and 72% of the Missouri costs are allocated as toll costs and thereby are subsidized by toll services. This is precisely the type of toll subsidy that creates the economic incentive for customers to bypass the established telephone network. The FCC Access Charge Plan is designed to reduce the economic incentive to bypass.

With regard to the BLSAP, please be advised that the Board of Directors of the Iowa Telephone Association has unanimously endorsed the language in the BLSAP bill as the proper method to assist eligible households in obtaining basic local residential telephone service, should a lifeline service be necessary. In Minnesota, where we were asked to comment on a Public Utilities Commission Discussion Paper with regard to Ameliorated Rates, our intent remains the same -- should lifeline service be necessary, the BLSAP model would be the most workable and the most equitable, in our opinion.

United Telephone System will continue to work with the Congress, the FCC, the State Legislatures, and the State Public Service Commissions with respect to these vital concerns, while the FCC's access charge plan is being implemented and thereafter. If I can be of further assistance to you, please do not hesitate to contact me. Thank you for your interest in this regard.

Sincerely,

R. B. Cashwell

mw
pc Congressman Ike Skelton

Attachment A

Analysis of Non-Traffic Sensitive (NTS) Costs

United Telephone Company of Missouri

	State	Interstate	Local	Total
NTS Investment:				
Outside Plant	$ 33,165,336	$ 30,990,705	$ 24,171,796	$ 88,327,836
Circuit Equipment	2,872,964	2,684,585	2,093,894	7,651,443
Station Apparatus (Non CPE)	1,441,460	1,346,945	1,050,575	3,838,980
Drop & Block	3,562,495	3,328,905	2,596,443	9,487,843
Inside Wire	11,233,428	10,487,515	8,179,939	29,890,882
Annual Revenue Requirements (Costs):				
Outside Plant	$ 9,417,297	$ 8,461,702	$ 6,925,945	$ 24,804,944
Circuit Equipment	1,083,251	984,733	794,591	2,862,575
Station Apparatus (Non CPE)	757,905	692,855	555,218	2,005,978
Drop & Block	1,873,124	1,712,355	1,372,194	4,957,673
Inside Wire	5,901,166	5,394,673	4,323,016	15,618,855
Total NTS	$ 19,032,743	17,246,318	$ 13,970,964	$ 50,250,025
Access Lines				147,905
Annual Revenue Requirement Per Access Line	$128.68	$116.60	$ 94.46	$339.74
Monthly Revenue Requirement Per Access Line	$10.72	$ 9.72	$ 7.87	$25.31
% of Monthly Revenue Requirement	37.9%	34.3%	27.8%	100.0%

Revenue Requirement includes:
- Return on investment and applicable income taxes
- Maintenance Expense
- Depreciation Expense
- General Overhead Expenses

Definitions:

OSP - Equipment connecting central office to customer drop wire.

Circuit Equipment - Equipment in central office that is not traffic sensitive.

Station Apparatus (Non CPE) - Paystations and company official terminal equipment.

Drop and Block - Telephone line from customer pole or junction box to the residence or business and the protector on the customer premise.

Inside Wire - Wiring in customers premise.

Analysis of Non-Traffic (NTS) Sensitive Costs

United Telephone Company of Kansas

	State	Interstate	Local	Total
NTS Investment:				
Outside Plant	$ 10,985,060	$ 15,686,721	$ 7,089,967	$ 33,761,748
Circuit Equipment	913,605	1,304,633	589,658	2,807,896
Station Apparatus (Non CPE)	335,489	479,080	216,531	1,031,099
Drop & Block	1,117,224	1,595,401	72,1078	3,433,703
Inside Wire	3,121,326	4,457,269	2,014,563	9,593,159
Annual Revenue Requirements (Costs):				
Outside Plant	$ 3,356,265	$ 4,803,745	$ 2,331,039	$ 10,491,049
Circuit Equipment	341,880	488,937	231,665	1,062,482
Station Apparatus (Non CPE)	177,440	253,745	119,924	551,109
Drop & Block	590,900	845,004	399,362	1,835,266
Inside Wire	1,650,869	2,360,793	1,115,746	5,127,408
Total NTS	$ 6,117,354	$ 8,752,224	$ 4,197,736	$19,067,314
Access Lines				65,503
Annual Revenue Requirement Per Access Lines	$ 93.39	$133.62	$ 64.08	$291.09
Monthly Revenue Requirement Per Access Line	$ 7.78	$ 11.13	$ 5.34	$ 24.25
% of Monthly Revenue Requirement	32.1%	45.9%	22.0%	100.0%

Revenue Requirement includes:
- Return on investment and applicable income taxes
- Maintenance Expense
- Depreciation Expense
- General Overhead Expenses

Definitions:

OSP - Equipment connecting central office to customer drop wire.

Circuit Equipment - Equipment in central office that is not traffic sensitive.

Station Apparatus (Non CPE) - Paystations and company official terminal equipment.

Drop and Block - Telephone line from customer pole or junction box to the residence or business and the protector on the customer premise.

Inside Wire - Wiring in customers premise.

Attachment B

A BILL FOR

An Act to establish the Basic Local Service Assistance Program to assist eligible households in obtaining basic local residential telephone service, to appropriate state general funds, and to provide a penalty.

Section 1. NEW SECTION. 476.61 POLICY DECLARATION.

The General Assembly finds that most residents of Iowa currently have affordable local telephone service, brought about, in part, by a subsidy from long distance services. The introduction of competition into long distance service is causing telecommunications services to be priced closer to cost, thus resulting in lower priced long distance services and higher priced local service.

The General Assembly finds that local residential telephone service is a basic human need. To insure that the advent of competition in the telecommunications industry does not deprive Iowans of this need, the Basic Local Service Assistance Program (BLSAP) is hereby established to provide assistance to eligible households to offset the rising costs of local residential telephone service. The Iowa Energy Policy Council will administer the BLSAP beginning July 1, 1985.

Section 2. NEW SECTION. 476.62 ELIGIBILITY FOR THE BASIC LOCAL SERVICE ASSISTANCE PROGRAM.

Basic local service assistance shall be available only to households which have incomes at or below one hundred fifty percent of the current poverty level guidelines as set by the Office of Management and Budget. Proof of income eligibility, definitions of income, and further income criteria and guidelines shall be established by the Energy Policy Council based upon those applicable for the low-income home energy assistance program. Persons residing together shall be eligible only if they jointly meet the income and asset guidelines established by this section. Only those who use telephone service for personal use at their principal place of residence within the state shall be eligible. BLSAP participants shall not have telephone service at more than one location in the state, except that this does not prohibit a BLSAP participant from having business telephone service at a location other than that for which assistance is provided.

Unless required by physical disability, BLSAP participants shall not have more than one telephone line at the person's residence.

Section 3. NEW SECTION. 476.63 APPLICATION FOR THE BASIC LOCAL SERVICE ASSISTANCE PROGRAM.

Applicants for BLSAP shall apply to their local agency administering the low-income home energy assistance program. If the applicant is found to be qualified, the agency shall issue a certificate of eligibility to the applicant and record the applicant's name and address with the commerce commission.

The community action agencies which have subcontracts with the energy policy council to act as local administering agencies for the low-income home energy assistance program shall also serve as local administering agencies for BLSAP by meeting program and fiscal requirements. The community action agencies are required to sign an agreement which specifies allowable program activities, special conditions, program and fiscal reporting to the energy policy council, participation forms and audit requirements.

Applicants for BLSAP shall have recourse to the appeal and hearing procedure available to applicants for the low-income home energy assistance program if the application is denied or if the assistance amount is not accurately determined.

Section 4. NEW SECTION. 476.64 FUNDING.

Funding for the Basic Local Service Assistance Program shall be appropriated out of the State's general fund. This appropriation shall be under the direction of the energy policy council. The energy policy council shall, by (date), and every (date) thereafter, certify to the State Treasurer the amount needed by the BLSAP for the next calendar year. In the event that it appears all BLSAP funds will be expended, the Iowa energy policy council will be required to establish a priority for payments on approved households. The local administering agency must notify the Iowa energy policy council, in writing, when five percent or less of its contract program budget remains unobligated. The following prioritized payment procedure will be used:

1. Payments will be prioritized according to the date and time of application as recorded on the top of the intake form.
2. In order to be fair to the homebound and handicapped, the date and time of application shall be recorded when the household contacts the office for assistance, not when the home visit is made.

Section 5. NEW SECTION. 476.65 ASSISTANCE PAYMENTS

Eligible households will receive assistance payments directly from the local administering agencies. Assistance payments shall equal fifty percent of the basic local service rate. In all exchanges or wire centers, where local measured service is offered, assistance payments shall equal fifty percent of the basic local measured service rate.

Section 6. NEW SECTION. 476.66 PENALTIES

A person applying for or receiving basic local service assistance who knowingly supplies false information or withholds information required to be supplied concerning an application for participation or continued participation in the Basic Local Service Assistance Program is guilty of a fraudulent practice.

EXPLANATION

This bill establishes the Basic Local Service Assistance Program to help low-income households pay for local telephone service. The Iowa energy policy council will administer the program. The same guidelines followed by the Low Income Home Energy Assistance Program will be used to determine eligibility.

Assistance payments will be payed directly to program participants and will equal fifty percent of the local measured service rate or the local basic service rate. Funding for the program will be appropriated from the State's general fund. A criminal penalty is imposed on persons who knowingly supply fraudulent information when applying for assistance.

The bill takes affect July 1 following its enactment.

APPENDIX C

United
Telephone
System

Roger L. Herdt
Director of Government Affairs

United Telephone Company of Minnesota
850 Norwest Center • St. Paul, Minnesota 55101 • (612) 221-1047

July 20, 1984

Mr. Randy Young, Executive Secretary
MINNESOTA PUBLIC UTILITIES COMMISSION
780 American Center Building
160 East Kellogg Boulevard
St. Paul, Minnesota 55101

RE: PUC DISCUSSION PAPER - AMELIORATED RATES

Dear Mr. Young:

In response to your memorandum of May 11, 1984, United offers to the Commission the following brief and general statement with regard to the PUC discussion paper:

> United Telephone Company of Minnesota (United) believes that most residents of Minnesota currently have affordable local telephone service, brought about, in part, by a subsidy from long distance services. The introduction of competition into long distance services is causing telecommunications services to be priced closer to cost, thus resulting in lower priced long distance services and higher priced local services.
>
> United also believes that local residential telephone service is a basic human need and that the advent of competition in the telecommunications industry should not deprive Minnesotans of this need. Should we, in Minnesota, find that an assistance program is needed to offset the rising cost of local residential telephone service, United would propose a "Basic Local Services Assistance Program" (BLSAP).
>
> Our proposal would provide that the Basic Local Service Assistance Program be made available only to households which have incomes at or below 150% of the current poverty level guidelines as set by the Office of Management and Budget. Proof of income, eligibility, definitions of income and further income criteria would be established by the appropriate state agency based upon those applicable for the low-income home energy assistance program. The qualifying applicants could be certified by their local agency administering the low-income energy assistance program.

> United proposes that funding for such a "Basic Local Service Assistance Program" be appropriated out of the state's general fund and the appropriation be administered under the direction of the appropriate designated state agency.
>
> Eligible households would receive assistance payments equal to 50% of the local basic service rate. In all exchanges where LMS is offered, assistance payments would offer 50% of the basic measured service rate.

Should the Commission want to discuss our statement in greater detail, we would be more than happy to do so. Also, we look forward to participating in further discussions and/or proceedings before the Commission regarding this issue.

Very truly yours,

Roger L. Herdt
Director of Government Affairs

APPENDIX D

Pacific Northwest Bell
Sixteen Hundred Bell Plaza
Seattle, Washington 98191
Phone (206) 345-4220

E. L. Pfeifer
Vice President

[illegible]
[illegible] 1984
REP. RON WYDEN

September 19, 1984

Honorable Ron Wyden
House of Representatives
1406 Longworth House Office Building
Washington, D.C. 20515

Dear Ron:

During the Special Task Force's hearing in Seattle, Congressman Swift asked for additional information on my statement that "in the business environment heavy users cost us more than light users, and light business users subsidize heavy business users."

To give you an idea of how this works, consider the Oregon businesses which have flat-rate, single party service. By and large, customers subscribing to this service can be considered "small businesses." Their basic monthly rate is now $38.65 and subscribers pay that amount whether they make one call or one thousand calls, whether they hold a connection for one minute or twenty-four hours.

As Dr. Bridger Mitchell and I explained, there is a cost to placing a local call — in Oregon, it's $.063 or about 6¢ — for a two minute call made during normal business hours to a phone located up to eight miles away. Just for the sake of illustration, assume that of the $38.65 monthly rate, $16.65 is allocated for local usage and the remaining $22.00 goes toward covering the cost of the non-traffic sensitive access line. Assume, too, that all business calls are two minute, eight mile calls. In this scenario — which, incidentally, is not too far from reality — $16.65 buys the customer about 278 local calls each month ($16.65 divided by 6¢). Simple arithmetic tells you that customers making more than 278 calls are not paying 6¢ a call and therefore are not covering the cost of their service. In fact, a customer making 600 calls is paying about 3¢ for each call. In the flat-rate environment, the light user is making up the 3¢ difference.

This is not just a hypothetical situation. In a four month study of the calling patterns of Oregon businesses with flat-rate, single party service, we found that the number of calls per line averaged about 242. We also found that roughly 75% of the lines were at or below this call average. Contrast that to the heaviest users -- 5% of the lines averaged from 500 to 1,300 calls per month.

To reiterate: there is a cost associated with local usage and today that cost is bundled in the flat rate. The flat rate assumes an average number of calls per month and therefore over time, if an individual business user is below that average, that user is subsidizing the business user who exceeds the average. While it is true that a business's usage per line will vary, it is also true that there is a segment of the business population which consistently exceeds the average, and does so by a large amount. By the same token, there are businesses which consistently underrun the average. Under the Fully Measured Business plan, each business would be charged only for its individual usage and the cross-subsidy inherent in the average flat-rate plan would be eliminated.

When setting the Fully Measured rates, the Commissioner faced a tough balancing act. He had to keep PNB's business revenues at basically the same levels while simultaneously preventing the impacts from falling on any one business segment. In the end, he made informed management decisions about the rate structure, as he is empowered to do. You have been critical of his decision to set hunting rates above cost, but you have not said where the revenue would come from if he had set a lower rate. I can assure you that the effect of lower hunting rates would be higher line or usage rates -- either of which would impact the small business user.

You were also concerned about the difference in measured business rates between approved Oregon and existing Illinois and California plans. I am enclosing our study, the data for which was obtained from 1983 year-end material filed with the FCC. You will note that when the total plans are compared rather than isolated elements, Oregon's plan is very comparable to those in Illinois and California. This is due in part to the fact that the local calling areas in those two states are much smaller than Oregon's and, as I mentioned, their rates for the higher distance bands are much greater than PNB's.

I am enclosing a copy of a recent Wall Street Journal article which describes Pacific Bell's request for a 30.9% surcharge on basic rates. Applying that percent to California's average local service bill brings the total to $62.22 — a substantially higher bill than Oregon's.

Having given you this information, let me now say that I do not consider such rate comparisons particularly meaningful. The telephone histories, customer bases, geographical territories and equipment costs vary tremendously among the three companies. Given the differences, it would be remarkable if they had the same rates and rate structures. The significant fact is that California and Illinois have had non-optional business measured service for decades and have not experienced economic decline or chaos because of it.

I would be very happy to answer any additional questions you might have, especially any relating to the usage sensitivity of local calls.

Sincerely,

Enclosures

cc: Congressman Al Swift

Business Measured Service Comparison
Oregon* - California - Illinois

Access Line:

Oregon	$32.25
California	$ 8.25
Illinois	$ 5.58 - $12.58 (Based on distance from core of exchange)

Hunting:

Oregon	$ 7.00
California	$ .50
Illinois	No charge

Conditioning:

Oregon	$ 5.00
California	No charge
Illinois	0 - $4.00 (Based on distance)

Usage:

Oregon

Distance	Init. Min.	Add'l. Min.
0-8	5¢	2¢
9-12	5 1/2¢	2 1/2¢
13-16	6¢	3¢
17+	6 1/2¢	3 1/2¢

California

Distance	Init. Min.	Add'l. Min.
0-8	4¢	1¢
9-12	8¢	3¢
13-16	10¢	5¢
17+	Toll	

Illinois

Within Chicago exchange 4 1/2¢ per call untimed
Outside of Chicago (1 unit = 4 1/2¢)

Distance	Initial Min.	Add'l. Period
0-4	1 unit = 5 mins.	1 unit = 2 mins.
5-8	2 units = 3 mins.	" "
9-15	3 units = 3 mins.	" "
16-20	4 units = 3 mins.	1 unit = 1 min.
21-25	5 units = 3 mins.	" "
26-30	6 units = 3 mins.	" "
31-40	7 units = 3 mins.	" "
41-55	8 units = 3 mins.	2 units = 1 min.
56-70	9 units = 3 mins.	" "
71-85	10 units = 3 mins.	" "

* From FMB Order 6-12-84

Call Charge Comparison

3 Minute Call in the Various Distance Bands

Oregon	Charge
0-8 miles	9¢
9-12 "	10-1/2¢
13-16 "	12¢
17 & over	13-1/2¢

California	Charge
0-8 miles	6¢
9-12 "	14¢
13-16 "	20¢
17 & over	Toll

Illinois	Charge
0-4 miles	4-1/2¢
5-8 "	9¢
9-15 "	13-1/2¢
16-20 "	18¢
21-25 "	22-1/2¢
26-30 "	27¢
31-40 "	31-1/2¢
41-55 "	36¢
56-70 "	40-1/2¢
71-85 "	45¢

Average Local Service Bill:

Oregon	$48.27	
California	$47.53	($62.22 with proposed 30.9% surcharge)
Illinois	$51.13	

Pacific Northwest Bell

D 5984 (1-84)

Paper: Wall Street Journal
City:
Date: 9/12/84 Page: 10

Community Affairs - Washington
Press Relations (206) 345-6149
Community Affairs - Oregon
Press Relations (503) 242-5256

FILE: Other Bell -- Rates

Beierle, Samson, Wilson, Walker, Pinnt, Selberg, Sanderson, Stever, Lerard

Pacific Bell Seeks Surcharge of 30.9% In California Rates

By a WALL STREET JOURNAL *Staff Reporter*

SAN FRANCISCO—Pacific Bell, a unit of Pacific Telesis Co., asked the California Public Utilities Commission for a flat 30.9% surcharge to its basic telephone rates, beginning Jan. 1, 1985.

The surcharge would amount to $1.36 billion in additional revenue a year.

Under the proposal, basic residential telephone service would increase to $10.80 a month from $8.25. Toll-call charges also would rise. As a result, the total increase in the average customer's bill would be about $6 a month. Special "lifeline service" available to low-income households wouldn't be affected.

Last month, Pacific Bell said it planned to seek rate increases totaling $1.36 billion. However, the commission has asked the utility for detailed studies of ratepayer usage patterns before ruling on how such an increase should be apportioned among Pacific's various types of telephone service. Those studies may take until mid-1985 to complete and even longer for the commission to evaluate, according to Reed Waters, vice president, regulatory affairs.

The temporary surcharge, if approved, would start providing Pacific Bell with the revenue stream it contends it needs to meet increased costs since the breakup of American Telephone & Telegraph Co. The surcharge would stay in effect until the commission has a chance to rule on the utility's rate-increase plan.

The rate request follows a two-phase $565 million annual rate increase that took full effect last July 1. That increase was half the amount sought by the company.

COMMONWEALTH OF PENNSYLVANIA

PUBLIC UTILITY COMMISSION

Petition Requesting the Commission to Institute a Generic Investigation Concerning the Development of Intrastate Access Charges	:	Docket No. P-830452

TESTIMONY OF

WILLIAM H. MELODY

ON BEHALF OF
OFFICE OF CONSUMER ADVOCATE
OF THE COMMONWEALTH OF PENNSYLVANIA

AUGUST 1984

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DIRECT TESTIMONY OF DR. WILLIAM H. MELODY

Qualifications

Q. State your name and occupation.

A. My name is William H. Melody. I am a Professor, and former Chairman in the Department of Communication, Simon Fraser University, Vancouver, British Columbia. I am also President of William H. Melody and Associates, through which I do consulting on a part-time basis.

Q. What previous positions have you held?

A. (1) 1971-76: Associate Professor of Communications Economics, Annenberg School of Communication, University of Pennsylvania, Philadelphia.

(2) 1966-71: Senior Economist, Federal Communications Commission, Washington, D.C.

(3) 1963-66: Assistant Professor, Department of Industrial Administration, Iowa State University, Ames, Iowa.

Q. What is your education?

A. B.S. (Accounting), M.A. (Finance), Ph.D. (Economics), University of Nebraska.

Q. Summarize your qualifications in telecommunications regulation.

A. I have been directly involved with research, teaching, provided over the same network of local distribution facilities. An allocation of costs for local loop access is made to them. Assuming this allocation to private line is a reasonable reflection of cost causation, then the remaining access costs would be applicable only to the network services indicated.

Q. Is it possible to determine whether the network services as a whole are covering their costs?

A. This can be tested by comparing the sum of all revenues of the network services with the sum of their respective direct costs plus the access line costs. The results are indicated in Table 2.

Table 2 indicates that the network services as a group provided a contribution of approximately $112.5 million in 1982, even when all access costs are included. It also shows that local exchange service provided a contribution of 1.72 times its direct cost, intrastate toll provided a contribution of 2.18 times it direct cost, and interstate toll provided a contribution of 3.03 times its direct cost.

Q. Does the lower ratio of Revenues to Direct Cost for local services in comparison to toll services mean that local service is making a lesser contribution than toll above their respective total costs?

A. Not necessarily. As discussed above, the common local exchange costs are caused to a greater degree by toll services than by local services. Therefore, after

Table 2

Bell of Pennsylvania
Embedded Direct Analysis Results
Local and Toll Network Service

1982 ($000,000)

	Revenues/ Direct			
Service Category	Revenues	Costs	Contribution	Cost
Local Exchange	628.50	364.79	263.71	1.72
State Toll	417.92	191.36	226.56	2.18
Interstate Toll	477.11	157.69	319.41	3.03
Total Network	1523.53	713.84	809.68	2.13
Access Costs		697.18	(697.18)	
Total	1523.53	411.02	112.51	1.08

Source: Bell of Pennsylvania, EDA Results, 1982.

an allocation of common costs on a cost causation basis, the contribution of local service will be improved relative to the toll services. One cannot tell until the allocations are made.

Q. Does the EDA data demonstrate that local exchange service is being subsidized by other services?

A. No. It indicates that the network services are making contributions to the non-network services. And among the network services, local exchange revenue is making a significant contribution over its respective direct costs.

The Components of Access Costs

Q. It is claimed that access costs represent the fixed, non-traffic sensitive (NTS) costs associated with the local loop between the central office and the customer premise. Do they?

A. No, they do not. NTS is an arbitrary cost category created for the sole purposes of calculating an interstate revenue requirement under jurisdictional cost separation rules. There is an enormous difference between the so-called theory of access line costs and the reality of the specific cost elements and amounts that are included in the cost calculation.

The standard theoretical explanation is that every subscriber needs a loop to connect a residence or business location to a central office. It is claimed that this loop is devoted solely to the individual subscriber. Thus, it is a fixed cost per subscriber line for access to the telephone system.

But in reality, loop plant is not supplied on a line by-line basis. The loop plant coming out of the central office is generally main distribution cable with a capacity of several hundred to several thousand lines that will be used as the telco chooses to allocate them. The actual number of lines activated as revenue producing local loops (or lines), as well as the cost per loop, depends upon the efficiency of the telco's design and planning of its local facility network of distribution cable and its forecast of subscriber demand for lines. On occasion there will be a concentration of lines even before they all reach the central office, e.g., party lines, community dial offices, etc., so that the number of activated telephone lines connecting the central office is less than the number of lines actually connecting subscribers.

As the distribution cable in the local distribution network comes closer to the subscriber's premises, the capacity of the feeder cable will be smaller, but the problem of network planning and cable utilization is the same. Only when one reaches the drop wire connecting the distribution cable running down the street with a specific subscriber location is there sometimes a direct relationship between the "loop" facility and the individual subscriber. And even here, there is great variance among the different types of loops connected to business and residence customers. For businesses using space in buildings, the last stage "loop" facility devoted solely to their use may be distribution cable running down the hall of a floor in the building. And even among standard resident loops, many residences now have two telephone lines in their drop wires, others have one, and telcos install as many as five lines and more in some neighborhoods.

Access costs per loop are determined simply by dividing the total costs assigned to access by the total number of loops. Loop costs are determined by the design standards used for the different types of loops, e.g., local voice versus data, and the efficiency of local network planning. Obviously, if loop costs are imposed arbitrarily on subscribers as a fixed access charge, there is little incentive for efficiency on the part of the telco. Rather there is an incentive to maintain very comfortable conditions of excess capacity. In recent years, most telcos have been connecting two lines in drop wires to most residential subscriber premises, anticipating that many homes will eventually desire a second line for enhanced services. Thus, the characteristics of local loop plant are really no different than other types of telco facilities. The vast majority of it is common local distribution plant designed to supply a multiplicity of services and used by subscribers purchasing a variety of different services. Thus, it is apparent that the local distribution costs are not uniquely associated with individual subscribers in the same manner as a telephone, for example. They are common system costs that vary with reference to types and quantities of services provided and the efficiency of the company as well as the number and location of subscribers.

Q. What are the components of cost included in the access line category?

A. The access line cost category includes much more than the specific identifiable cost of subscriber loops. Access line investment consists of the sum of allocated portions of virtually all asset accounts. As indicated in Table 3, these include not only loop outside plant, but central office equipment, station investment, furniture, and motor vehicles as well as land and building space used by operators, revenue accounting and general office staff. This allocation of NTS investment reflects the result of an arbitrary separation of costs into two categories for purposes of applying different allocation formulae so as to meet the requirements of jurisdictional cost separations. The categories were labelled traffic sensitive and non-traffic sensitive, not after testing the actual traffic sensitivity of the investment components, but rather for the convenience of achieving the desired separations results. Clearly, if one sought to identify the actual investment in loop plant, the majority of these investment allocations would be excluded from access line investment.

Q. What specific expense items are included in the calculation of the annual costs of the access line?

A. As in the case of investment, portions of virtually every expense account have been allocated to the access line as shown in Table 4. This includes maintenance, depreciation, return and taxes on the commercial office space and motor vehicles allocated to access line investment. It includes a share of commercial and marketing expenses, pensions and general services and licenses. Between 1977 - 1983 the largest increases in access line expenses occurred in accounting and commercial and marketing expenses.

Once again, there is no attempt to identify the direct expenses associated with the specific loop plant. It is simply allocated a share of all expenses. If one sought to identify the actual expenses associated with the loop plant, the great majority of these expense allocations would be removed from access line expenses.

The term "access line" is a misleading label for this category of investment and expenses. It would be more correctly labelled as a special "clearing account" to which a different set of allocation rules are to be applied in the jurisdictional cost separations procedures, so as to allocate the desired proportion of total costs to the interstate jurisdiction.

Q. Are access line costs measured by including only non-traffic sensitive costs, or do they include other costs as well?

A. For most Bell Operating Companies NTS costs represent approximately 90% of total access costs. The additional costs assigned to access generally are service order activity and billing.

Table 3
Bell Telephone of Pennsylvania
EDA Investment Assignments
to Access Line

1977 - 1983 ($000.000)

Plant Category	1977 Access[1]		1978 Access		1979 Access		1980 Access		1981 Access		1982 Access		1983 Access		Increase 1977-1983	
	$	%	$	%	$	%	$	%	$	%	$	%	$	%	$	%
Central Office Equipment																
Subs. loop-Circ. COE	34	87	37	83	41	83	44	87	65	87	77	86	111	87	77	224
Local Dial	181	25	195	24	214	24	222	24	231	24	238	24	239	24	58	32
Other	0	0	3	1	5	1	5	1	6	1	7	1	7	1	N/A	N/A
Total	215	16	235	16	260	16	272	16	301	17	322	17	357	18	142	66
Outside Plant																
Subscriber Loops	845	89	906	88	985	88	1,079	88	1,177	87	1,408	93	1,507	93	657	78
Other	0	0	0	0	0	0	1	0	0	0	1	0	1	0	N/A	N/A
Total	845	71	907	70	986	70	1,079	70	1,177	70	1,409	77	1,507	78	662	78
Station Equipment																
Station App.	79	20	78	18	82	18	29	6	30	6	40	7	45	9	(34)	(43)
Station Con.	223	51	240	50	266	51	248	44	150	24	154	22	165	23	(58)	(26)
Large PBX	3	2	4	2	4	3	0	0	0	0	0	0	1	1	N/A	N/A
Total	304	31	321	31	351	31	277	23	180	14	194	14	210	15	(94)	(31)
Land & Buildings	64	17	70	17	75	17	88	19	94	19	109	21	118	23	54	83
Furniture & Office Equipment	6	13	14	25	22	30	39	44	49	49	68	51	82	55	76	1270
Vehicles & Equipment	30	57	33	57	37	56	43	54	45	48	49	53	58	53	28	92
Total Plant in Service	1,464	37	1,580	37	1,731	37	1,799	35	1,847	34	2,152	37	2,332	38	868	59

Source: Bell of Pennsylvania; Exeter Associates

Note 1: Percent of Total Account.

Note 2: Numbers may not add due to rounding.

Table 4
Bell Telephone of Pennsylvania
EDA Expense Assignments
to Access Line

1977 - 1983 ($000,000)

Expense Category	1977 Access		1978 Access		1979 Access		1980 Access		1981 Access		1982 Access		1983 Access		Increase 1977-1983	
	$	%	$	%	$	%	$	%	$	%	$	%	$	%	$	%
Traffic	11	11	12	13	13	13	12	12	13	13	13	13	13	12	2	19
Com'l & Marketing	37	28	43	27	52	29	63	31	77	32	88	31	94	38	57	154
Accounting	16	38	18	42	19	40	31	57	38	64	40	64	45	62	29	184
Maintenance	91	30	99	29	111	29	114	29	117	25	133	27	142	27	51	56
Gen. Services & Licences	0	0	12	37	14	37	6	14	6	12	5	12	5	14	N/A	N/A
General Office	0	0	0	0	1	2	1	1	0	1	12	15	13	14	N/A	N/A
Relief & Pension	28	24	33	25	39	27	56	30	48	27	58	29	57	31	29	105
Depreciation	67	35	74	35	77	31	77	28	69	22	98	24	111	26	44	64
Operating Rents	5	52	4	31	5	33	7	43	8	37	9	40	11	42	6	110
Other Expenses	0	0	(2)	(97)	(3)	(48)	(3)	11	(3)	10	(4)	13	(5)	47	N/A	N/A
Taxes other than Inc.	15	16	17	16	19	16	22	16	23	16	22	15	37	20	22	139
Int. Chgd. Constr.	(2)	23	(3)	24	(1)	27	(1)	22	(0)	30	(1)	41	(1)	25	N/A	N/A
Income Taxes	57	38	69	38	71	38	64	36	66	34	75	37	109	40	52	93
Return	98	38	115	38	130	38	132	36	132	34	155	37	183	40	85	88
Total Cost	421	29	489	30	547	30	578	30	599	27	704	29	812	31	391	93

Source: Bell of Pennsylvania, Exeter Associates

Note: Numbers may not add due to rounding.

Q. Have access line investment and expense costs tended to remain fixed over the years?

A. No. For most large telcos, they have been increasing rapidly. Table 5 provides for Bell of Pennsylvania a comparison of the increases in access line costs, as well as the direct costs for the network services for the 1973-82 period. This data shows that the access line costs have increased more rapidly than the direct, primarily usage related costs of the local, intrastate toll and interstate toll services combined. In percentage terms, access line costs have increased 160.1% as compared to direct costs for the network services 108.3 to 126.2%. Table 5 also indicates the net increase in exchange circuits or access lines has been only 23.9% over the same time period. Clearly the major component of cost increases by Bell of Pennsylvania are occurring in the network access category.

The large amounts, and the rapid rate of increase in access line costs could be explained by three possible factors:

(1) A very rapid growth in new subscribers who are connected to the system, since access line costs are supposed to be a direct function of subscriber lines;

(2) A substantial program of investment in upgrading access lines to existing customers as a basis for providing enhanced services; or

Table 5

Bell of Pennsylvania
Network Costs

1973 - 1982 $(000,000)

	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1973 - 1982	
											$	%
Network Access	268.1	289.5	308.5	351.7	421.4	488.8	547.1	575.1	596.8	697.2	429.1	160.1
Direct Cost:												
Local (Usage)	161.3	173.4	184.9	199.8	231.4	256.5	274.1	300.1	328.0	364.8	203.5	126.2
State Toll	91.9	105.3	111.4	118.8	123.1	148.2	154.8	168.3	183.7	191.4	99.5	108.3
Interstate Toll	74.5	80.0	85.8	91.6	104.2	112.4	124.4	135.7	145.9	157.7	83.2	111.7
Exchange (#) Circuits (M) (Access Lines)	3.578	3.695	3.789	3.894	3.995	4.112	4.216	4.295	4.369	4.434	856	23.9

Source: Bell of Pennsylvania, EDA Results, 1973 - 1982; Schedule 51, Form M Annual Report, 1973 - 1982

(3) The inclusion in the access line cost category of investment and expense costs that are not causally related to the provision of an access line and should be assigned elsewhere.

Since the net increase in access lines between 1973 and 1982 has been only 23.9% (about 2% per year), it is extremely doubtful that new subscriber connections have caused the rapid increase in access costs. A breakdown showing increases in access lines by major service category is given in Table 6. Between 1976 and 1983 residence access lines increased only 6.5% in comparison to business 32.0% and other (primarily business related) of 368.5%. Clearly the causers of the major cost increases in the access line category are not the residential users of plain old telephone service.

On the other hand, upgrading the network for enhanced services appears to have been a major factor causing access costs to increase. In addition, as demonstrated above, the investment and expense accounts included in the access line cost category include allocated costs that have no causal relation to the supply of subscriber access lines.

If access line costs are to be calculated on a cost causal basis, the entire cost methodology will have to be reassessed. The result of the reassessment will be a major reduction in access costs and an increase in the direct costs of virtually all other service classifications.

Table 6

Bell of Pennsylvania
Residence and Business Access Lines
(Including PBX Trunks & Centrex)

1976 - 1983 (000,000)

	1976	1977	1978[1]	1979	1980[2]	1981	1982	1983	Increase %
Residence	3.116	3.155	3.193	3.241	3.276	3.296	3.296	3.317	6.5
Business	.791	.884	.937	.963	.993	1.016	1.020	1.044	32.0
Other[3]	.089	.091	.091	.094	.429	.428	.422	.417	368.5
Total	3.996	4.130	4.221	4.298	4.698	4.740	4.738	4.778	19.6

Note: 1. PL data prior to 1978 unavailable.
2. ENFIA begins 1980
3. Other includes Private Line Channels, WATS, 800, Public, Semi-Public, and ENFIA.

Source: Response and Informal Response of Bell of Pennsylvania to Interrogatory No. A-2 of OCA, May 11, 1984.

Q. Is your conclusion with respect to the specific cost characteristics of the access line category supported by any recent empirical study?

A. Yes. The National Regulatory Research Institute at Ohio State University published in December 1983 "A Study of Telephone Access Charges: An Empirical Analysis of Bell Companies in Five Regions". This study concluded, among other things, that:

> The third major policy area on which our study results bear has to do with the efficacy of the separations of traffic-sensitive costs. Our study disclosed that increases in traffic-sensitive toll costs increased local exchange revenue requirements. Careful examination of this result led us to hypothesize that the allocation of these costs in the separations procedure does not attribute these costs to the cost-causative service. This implies that there may exist a subsidy flowing from local exchange service to toll services. (Executive Summary, p. iv.)

Upgraded Exchange Facilities for Enhanced Service

Q. In addition to the data on the rapid growth of access line costs over the 1973-82 period, is there other evidence to support your claim that the local exchange facilities are being upgraded by Bell of Pennsylvania for the benefit of enhanced services?

A. Yes. These changes are described in Company Annual Reports. For example, in its 1981 Annual Report, the President of Bell of Pennsylvania stated that:

> "New technology was translated into new and improved products and services, supported by stronger marketing efforts. Tariffs were approved for the RSVP (Residence Service Variety Package), which turns the average home phone line into a sophisticated telecommunications system."(p.2)

Continuing efforts to upgrade the local exchange network are also reflected in the Chairman's remarks in the 1982 Annual Report:

> "This was a year characterized by our emerging role as gatekeeper to that Information Age,...Moving in that direction in 1982 we enhanced our position as the gateway through which customers access the nation's "intelligent" network and its multitude of applications." (p. 2)

Digitalization of Bell of Pennsylvania is also advancing rapidly. ESS equipment in the central office comprised 63% of switching equipment in 1982 as compared to the Bell System average of 51% (Bell of Pennsylvania, Annual Report, 1982, p. 4).

The role of the local exchange network in providing enhanced services also has been described by AT&T in its Annual Report for 1982. At page 14, AT&T comments that:

> "the local network is rapidly evolving into a flexible, all-purpose communications delivery system, capable of handling information in whatever form customers desire - voice, data, graphics, or video...Providing wideband transmission services over the loop plant holds great potential for extending a full range of Information Age Services to home and business customers."

The local facilities upgrading program has been necessary to accommodate the growth in enhanced services. These statements are consistent with similar statements being made by other telcos. These developments also are described widely in industry periodicals. They all point to the necessity for regulatory agencies to require changes in existing accounting and reporting systems for telcos so that the costs of upgrading for enhanced services can be identified and assigned to the services causing their incurrence.

Q. Is there evidence that the upgrading of the subscriber loop is affecting the way in which loops have been traditionally supplied?

A. The idea underlying access charges, i.e., that each subscriber is connected directly to the central office by a specific local loop uniquely devoted to the individual subscriber, is further undermined by these newer technological developments. The Bell of Pennsylvania 1982 Annual Report describes a trial with the first use of lightguide for subscriber line carrier. It states:

> "A SLC-96 installation (Subscriber Loop Carrier System), allows up to 96 individual subscribers to be wired into a remote terminal to be sent along to a switching terminal on just eight pairs of copper wire instead of the usual 96." (p.4)

Network Enhancement in the Context of Cost Causation

Q. When the local exchange network is upgraded, what types of costs are increased?

A. Enhancement of the local exchange network increases costs in two respects: (1) the investment and related costs incurred now in preparation for enhanced services that are expected to develop into full fledged services in later years; and (2) increased depreciation and premature obsolescence costs of existing telephone plant created by the company's decision to proceed with enhancement of the plant at the very rapid speed it has chosen (e.g., the conversion to electronic switching). There are additional factors prompting telco costs to increase, including FCC decisions relating to customer premises equipment, inside wiring, and depreciation, but the major driving force for cost increases today and for the foreseeable future relate to enhancement of the local exchange plant. They are not caused by basic telephone service.

Q. Under the current system of cost assignment, where are the increased costs of upgrading and enhancing the local exchange plant assigned?

A. They are simply classified as local exchange costs. The vast majority appear as direct costs of local exchange service or as common access costs that are assigned to local service. Thus, they affect both the assignment of costs between basic local telephone and enhanced services within the local exchange category, and the assignment of costs between local and toll. In addition, since the current system of cost assignment does not attempt to identify and assign all costs of enhancement to enhanced service, the current cost assignment methods will understate the costs of enhanced private line services as well.

Q. Has there been any attempt to determine the portion of telco local exchange costs that should be associated with enhanced services?

A. The available data that I have seen does not permit a detailed analysis that could quantify both the common and direct costs of enhanced services. However, to the extent that expansion projects, for example in central office switching, are prompted not by anticipated growth in the demand for telephone service, but rather by a desire of the telco to be prepared to supply enhanced custom calling services, these costs should be assigned to the services causing the cost increases, i.e., the enhanced services. They can be quantified by an analysis of existing capacity, growth requirements and the timing of expansion and replacement decisions.

The increase in depreciation of existing plant investment (e.g., crossbar switching) that is caused by a decision to replace it prematurely (e.g., with ESS) appears in the books of accounts as increased depreciation expense for the type of plant replaced (crossbar) and is not associated with the new plant (ESS). Unless a special effort is made to identify these costs and assign them to enhanced services, they will be assigned primarily to basic telephone service.

At present, it is not possible to calculate the total amount of costs that should be assigned to enhanced services. But it is clear that the major cause of increases in local exchange costs is enhanced services and not basic telephone service.

Q. Should all costs not associated with basic telephone service be assigned to enhanced services?

A. Not necessarily. A detailed examination of cost causation may show that some of the investment is associated with enhanced service, but some investment may not be necessary to meet any reasonable estimate of demand for any service. This latter category is simply excessive investment creating excess capacity. It is neither "used" nor "useful" and should be excluded from the rate base altogether.

This exclusion is necessary because the essentially cost-plus character of regulation provides the telco with an artificial incentive to overexpand its plant as long as the costs can be passed on to basic telephone users. Unless the Commission rejects excessive plant expansion, it is likely to continue indefinitely. Similarly, unless the costs of enhancing the local exchange network are identified and assigned to enhanced services, the telco is provided with an artificial incentive to enhance its plant as rapidly as possible rather than at the most efficient rate of conversion in light of realistic growth in demand.

Q. Why does the Commission need to focus increased attention on the local exchange network and enhanced services?

A. In the new telecommunications environment, the local exchange network is becoming a common resource for the supply of a wide range of local and long distance voice, data, information, video and other services. This network is accessed at one end by subscribers to a wide variety of information services. The local telco itself provides some of these, e.g., local and intraLATA long distance telephone. AT&T and other carriers supply long distance and other services. Paging companies and other mobile services use the local exchange network. Suppliers of specialized data and information services are seeking expanded access arrangements. All of these demands for access to the local exchange network by independent companies desiring to sell services to subscribers will require a detailed examination of the costs of local exchange facilities. This will be necessary in order to have a basis for judging the reasonableness of the rates charged to the independent companies supplying services and to subscribers for access to the local network. The importance of this problem is intensified by the fact that the local network is continuously being upgraded and modified at substantial cost to the telco to meet the needs of computer communications ; and also by increasing the variety of different types of specialized services that desire to use the valuable common resource the local exchange network.

In the past the most significant upgrading of the local exchange facilities occurred when the system of local telephone service was redesigned to meet the higher, and more expensive, standards of long distance. The present enhancement involves a fundamental upgrading to meet the higher standards, and higher costs, of computerizing the network, as well as other special enhancement to meet the needs of special services, e.g., Picturephone. In essence, the plain old telephone system is being upgraded into a giant telecomputer.

Q. Does this create a special cross-subsidy problem for regulatory commissions?

A. Yes. The same local exchange facilities are used in common to supply basic local telephone service, the origination and termination links for long distance services, as well as the higher grade, enhanced data and other services. At present in the telecommunications industry there is no system of cost allocation for assigning the costs of these common exchange facilities to the different types of services that recognizes the extent to which each type of service has caused the common facility or plant costs to be incurred.

Q. Can you illustrate this problem?

A. The technical evolution of the telecommunications facility network has gone through several distinct phases. The local exchange initially was designed and constructed essentially for local service. When long distance service was added, at first it was necessary to go to a special phone booth equipped to handle long distance calls. Then, the local plant was used to reach the entrance to the toll network. But this restricted the quantity, quality and distance of long distance service.

As long distance demand and transmission technology developed, it became necessary to redesign and upgrade the local exchange plant to meet the more stringent and more costly requirements of sending signals across the country, not just across town. This included virtually every aspect of local plant, including the quality and conditioning of the local loop circuit so that telecommunication signals could travel long distances, of switching (e.g., in more recent times, direct distance dialing), of the gauge of the wire used, the spacing of telephone poles, and even the design of the telephone instrument.*

The local exchange plant now in place was designed essentially for the characteristics and requirements of long distance service, not local telephone service. The exchange plant is much more costly than that which would be built to supply local service alone. Once the local plant is designed for toll service, adding local service requires a relatively small amount of additional costs.

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*For a detailed review of the history of these developments, see Richard Gabel, "Allocation of Exchange Plant Investment", in H.M. Trebing, ed., Adjusting to Regulatory Pricing, and Marketing Realities (East Lansing: Michigan State University, 1983) pp. 452-82.

The third phase in the design of local exchange plant is now in progress, as described frequently by Bell System management. Exchange plant is being upgraded at substantial cost to meet the requirements of data-oriented, enhanced services. This same plant will be used in common for local, long distance and enhanced services. Although basic local telephone service in particular will receive no significant benefit from this costly upgrading of the common exchange facilities, under existing costing methods both intrastate revenue requirements and basic local telephone service would be assigned the major share of these costs of upgrading and enhancing the exchange plant.

The principle of economic cost causation requires that the cost allocation method reflect the extent to which each of the types of services being provided over common facilities causes the common facility costs to be what they are. Thus, the long-run economic opportunity cost i.e., the cost of the best alternative means of supply -- of the different services must be recognized.

Q. Can you demonstrate this principle with a simple example?

A. Yes. Assume that the cost of providing a specified quantity of both local telephone and enhanced services over common exchange facilities is $25, while the cost of providing the services independently is $10 for local and $20 for enhanced. The cost of independent or stand-alone supply of each service tells us which one is the primary cause of the common cost, and the primary beneficiary of common supply.

It is in the interest of the enhanced service to enter into the common supply arrangement as long as local service will accept at least $5 of the common cost. If local service will bear more than $5, then the enhanced service can reduce its costs below $20, the cost of going it alone. But it is not in the interest of local service to participate in the arrangement unless the enhanced service would accept at least $15 ($25-$10) of the common cost. This is because local service can go it alone for $10. An equal sharing of common costs, i.e., $12.50 each, would provide a $7.50 ($20-$12.50) benefit to enhanced service and a $2.50 ($12.50-$10) penalty to local service for participation in the common supply option. Local service costs would be 25% higher if it participated in the common supply arrangement than they would be if it was supplied independently.

Obviously, if local service had a choice, it would not participate in such an arrangement. But in almost all situations, local service has no choice. The common supply option has been chosen by management. The negotiation over the appropriate cost sharing method, or the selection of the cost allocation rule, only comes later, after the common plant is constructed and costs recorded in aggregate accounts. Then, under the market pressure of keeping costs assigned to competitive services as low as possible, these costs are allocated to the monopoly service, not the services that caused the costs.

Q. Do you know of other circumstances where the principle of opportunity cost of independent supply has been recognized in costing and pricing services supplied over common facilities?

A. Illustrations where there is recognition of the opportunity cost of independent supply can be found in the costing of: (1) highways, which are primarily designed for heavy trucks, not cars, and where the tax structure reflects this fact; (2) water mains, where the larger capacity is designed for fire protection, not household use. Municipal water rates often are designed to recognize this principle: (3) multiple purpose hydro projects, where it is considered in determining revenue requirement costs for electricity rates; (4) the capacity of electric generating plants that are constructed to meet both capacity at peak demand and energy supply at all periods; and (5) multi-product firms competing in markets where competitors are supplying, or can supply each product independently. Under these circumstances, the competitive marketplace requires that the opportunity costs be considered by the ready alternative of independent supply.

Q. How would you apply this principle of cost causation to local exchange telephone plant for purposes of determining the costs to be associated with an independent revenue requirement for the basic local services?

A. For measuring cost causation in local telecommunications facilities, the basic fundamental characteristics of the common facilities must be examined to determine the extent to which each of the services causes the facility investment and expenses to be at the levels that actually are incurred.

An illustration would be the allocation of local switching costs. Major portions of local switching costs are to meet the requirements of toll (e.g., direct distance dialing) or specialized (e.g., digital data) services. The local switching required only for basic local telephone is much less costly. Economic cost causation requires that this factor be recognized for all types of plant in the cost allocation method.

Toward a Structure of Efficient Access Charges

Q. If access charges are imposed on long distance companies will they not just pass rate increases through to their customers?

A. Yes. The issue is not that rate increases are passed back to consumers as an aggregate group. Rather, the issue is to which consumers are these rate increases passed back. Sound economics requires that the costs be passed back to the consumers who benefit from the service. Thus, if access charges are imposed on the intercity carriers and enhanced service providers, these increased rates will be included in their costs and in the rates they charge, in turn, to users of their services. Those subscribers who benefit will pay. Those who do not benefit will not pay. If access charges are imposed on all subscribers unilaterally, then those who do not benefit must pay to subsidize those who do. Instead of economic efficiency based on cost causation, the result is simply private taxation in the guise of access charges.

Q. Is it economically more efficient to collect fixed costs through a fixed customer access charge rather than placing the charge on long distance usage?

A. Not necessarily. If the purpose is simply to establish a fixed charge per line to replace a usage charge as the basis for covering fixed costs, this can be done by charging the intercity carriers and enhanced service providers fixed, instead of usage sensitive access charges. There is no justification for shifting the charge directly to all telephone subscribers, in a manner that is unrelated to cost causation, as proposed by the FCC and, contemplated by the local telephone companies in Pennsylvania.

In competitive markets, the norm is for fixed costs to be recovered through variable, or usage charges. No competitive business can impose a charge on people who do not buy its products or services simply because the firm has fixed costs. Every firm has fixed costs.

The principle of recovering fixed costs by variable charges, in most circumstances, provides a very important incentive to economic efficiency, both in the utilization of fixed plant and in the allocation of fixed economic resources. The firm has a powerful incentive to use its fixed resources efficiently, and expand its investment in these resources only when it is efficient to do so, because if the firm does not do this, it will suffer losses. On the other hand, if the firm uses the fixed plant resources efficiently, it will gain extra profit. If the firm can simply dump all the fixed costs directly on subscribers, the incentive for efficiency in the utilization of fixed plant and in the allocation of investment in additional fixed plant is weak or absent. One must examine the economic circumstances to see what incentives are created before determining the most efficient rate structure. The FCC in its access charge order, and the local telcos in their present proposals, failed to do this.

The FCC access charge decision was purportedly based on cost causation, but its implementation would accomplish precisely the opposite. It would arbitrarily allocate to local subscribers costs caused by long distance and other enhanced services, whether or not they want them or use them. It fails to distinguish between different types of access for which there are different costs. And it ultimately would assign all costs of access directly to subscribers.

This would artificially encourage long distance carriers and enhanced service providers to demand access to the local network regardless of the access costs they cause, and it would reduce the incentive for the local telco to provide the local network as efficiently as possible. It would reduce the investment risk of local operating companies, and maximize opportunities for intercity carriers and enhanced service providers -- at the expense of basic telephone users. It would do this by exploiting the local telco's monopoly power over basic telephone subscribers who will be forced to subsidize toll and enhanced services in order to provide the local telco with an artificial competitive advantage in the supply of these services. This is a far cry from promoting efficiency in the design, construction and utilization of the local exchange network.

Q. Are you saying that the use of a fixed subscriber access charge to cover fixed costs is only possible when a firm has monopoly power and can pass its investment risks on to its captive customers?

A. Yes. Under conditions of unregulated monopoly the firm is not forced by competition to employ uniform usage rates. Because of its monopoly power, it can charge discriminatory rates for usage, either uniform or discriminatory fixed access charges, or any combination of usage and access charges. The theory of monopoly demonstrates how a monopolist may be able to use its monopoly power to realize monopoly profit and/or to pass business risks on to subscribers. W. Arthur Lewis, in his book on Overhead Costs, noted that, for a monopolist, "the risk of unforeseen change is a strong argument in favour of a fixed charge, which will throw upon the consumer any loss resulting from unfavourable change."*

The inefficiency of monopoly profit and monopolistic price discrimination has been extensively examined in theory and practice. Indeed public utility regulation has been established specifically to prevent such monopolistic pricing practices. But the monopolistic practice of using fixed charges to transfer risk has been less widely discussed. According to Lewis:

> Such devices run counter to the spirit of private enterprise. The essence of that system is that entrepreneurs are the specialists in risk-bearing. It is therefore very difficult to introduce such devices into an industry where entry is unrestricted and easy. There is usually some entrepreneur who is willing to charge the consumer per unit consumed, and

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*W. Arthur Lewis, Overhead Costs: Some Essays in Economic Analysis (New York: M. Kelley, 1970), p.57 . (fn. omitted).

> to assume himself the risk that over a number of years demand will be large enough for him to recoup all his costs; and where there are such entrepreneurs, consumers are unwilling to be tied by payment in advance or by any exclusive contract. Competitive private enterprise demands that overhead costs shall be recouped not through any fixed charge, as the theory of the two-part tariff suggests, but by inclusion in the variable charge.*

Q. It is argued by some economists that end-user access charges are necessary to maximize consumer welfare. Is this correct?

A. No. A rate structure for long distance telecommunication services consisting of a fixed access charge and variable usage charges is a two-part tariff. There is a substantial body of literature going back to the turn of the century that addresses both the theoretical and practical implications of the two-part tariff within the framework of economic welfare theory.**

The objective of this theory is to maximize consumer welfare. Welfare is maximized when consumers are charged no more than the added costs they impose on society when they purchase one additional unit of service. If a large scale investment in productive capacity already has been committed, e.g., a bridge, consumer welfare will be maximized as users are willing to pay a toll equal to the marginal cost of operating the bridge. Consumer welfare will not be maximized if any potential user is denied service because of an unwillingness or an inability to pay a toll greater than the short run marginal cost. Society loses because a higher toll prevents some consumers from purchasing service even though they would have paid a toll sufficient to cover the added costs to society of their crossing.

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*Ibid, pp. 56-57 (Fn. omitted).

**Perhaps the seminal treatise developing the welfare theory is Arthur C. Pigou, The Economics of Welfare (New York: St. Martin's Press, 1932).

Because the investment cost of the bridge does not vary with usage in the short run - a low toll does not stimulate so much use of the bridge as to overrun its capacity or to require another bridge to be built - the investment costs are not considered to be economic costs. According to the theory, economic costs are only those that can be escaped in the short run. The investment costs are not usage related. They are overhead costs of society that have to be recovered by some method of economic taxation.

If the toll is increased above short run marginal costs in order to recover the investment costs of the bridge, the toll increase is simply one method of taxation. As a method of economic taxation, it is inefficient because it restricts usage and reduces consumer welfare. According to the theory, efficient economic taxation should not be tied to consumer purchases, but rather should extract wealth without affecting consumer choice when the toll is set at short run marginal cost.

This analysis led some economists to propose public ownership of highly capital-intensive activities such as bridges, canals, highways, railroads, and public utilities, on grounds that the economic welfare of society would be maximized if these industries were monopolized, rates were set at short-run marginal cost and then investment programs were subsidized by general taxation.* It also led economists to assess critically the implications of alternative taxing schemes in terms of their welfare implications, and to propose taxing methods that would have a minimal restrictive impact on the optimal consumption patterns.**

The bottom line policy conclusions of this analysis are two: (1) it is economically inefficient to deny anyone access as long as they are willing to pay a usage charge equal to short run marginal cost; and (2) the most efficient method of recovering the fixed costs is by a taxing method that is unrelated to usage and socks it to the rich (whose consumption patterns will not be altered significantly by the tax) and goes very light on, or exempts, the poor (whose consumption patterns will be affected significantly). This would require a far different access charge structure than that proposed by the FCC, or by the telcos in this case.

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*See, e.g., Harold Hotelling, "The General Welfare in Relation to Problems of Taxation and of Railway Utility Rates" Econometrica, 1938, pp.242-269; William S. Vickrey, "Some Implications of Marginal Cost Pricing for Public(cont.p. Utilities" The American Economic Review Vol. 45, May 1955, pp. 605-620 and Microstatics (New York: Harcourt, Brace and World, 1964); Abba Lerner, The Economics of Control (New York: McMillan Co., 1964).

**See e.g., Frank Ramsey, "A Contribution to the Theory of Taxation", The Economic Journal, Vol. XXXVII, March 1927.

Q. Does this theory really apply in markets subject to competition and in industries subject to continuing investment?

A. Because most industries do not have the investment characteristics of bridges, the scope of application of short run welfare theory is limited. For most industries the use of existing capacity in the short run requires the incurrence not only of costs directly associated with usage, but also investment in additional capacity to serve demand on a continuing bases. Therefore, economic cost recognition must include the long run investment costs that, although fixed in the short run, are variable in the long run.

Where investment in additional capacity is being committed on a continuing basis, the monopoly condition assumed by the analysis of idle capacity gives way to the possibility of competition. In competitive markets, the availability of ready substitutes will tend to bring about uniform rates for similar services that cover both short run operating and long run investment costs. The force of

APPENDIX E

August 13, 1984

[illegible]

Ike Skelton
Congress of the United States
House of Representatives
Washington D.C. 20515

Re: Telephone Access Charges

Dear Mr. Skelton:

After reading your legislature update, concerning the FCC allowing telephone companies to begin charging business long distance access charges, I have become extremely upset.

I am appaled at how the government favors large corporations, and yet blindly ignores the small guys, like myself. This can be seen in the tax favors which large corporations receive, and it can be seen in other areas as well.

Let me tell you a little about myself. First, I am a twenty-four year old female, and I chose to go into business for myself, especially since I was unable to find a postion in my field of expertise that could pay my "necessary" living expenses.

Secondly, I have never had so much trouble trying to raise enough capital to start my business with. Everywhere you go people tell you to "go for it" but how can you? It is suppose to be the Great American Dream," where everyone has an equal chance to make something of themselves, but, this is just not true, because every door you open, twice as many get slammed shut in your face.

Lastly, I just opened my business in July 1984, and Southwestern Bell Telephone Company which services our area, has charged me an outrageous amount. There was the $250.00 deposit, than the phones with two lines cost $1,000, the one time charge for service and equipment $125.00, two business lines $97.80, two business touchtone lines $8.70, finally two interstate acess lines $9.40. The total, $1,490.90 without tax added. That might not seem like much money to most other companies, but it is to me. And now you tell me the FCC is going to allow the telephone companies to charge me more, simply because the large corporations get discounts for volume, therefore the telephone companies have to make up the difference somewhere else, namely small businesses like myself.

I don't know about you, sir, but I am outraged at the thought of this. There will come a time, when people like myself, will decide that they have had enough, and they will rise up, and do something about it. I am outraged at having to carry the burden of a "freeloader", especially when they have the funds available to pay their own way.

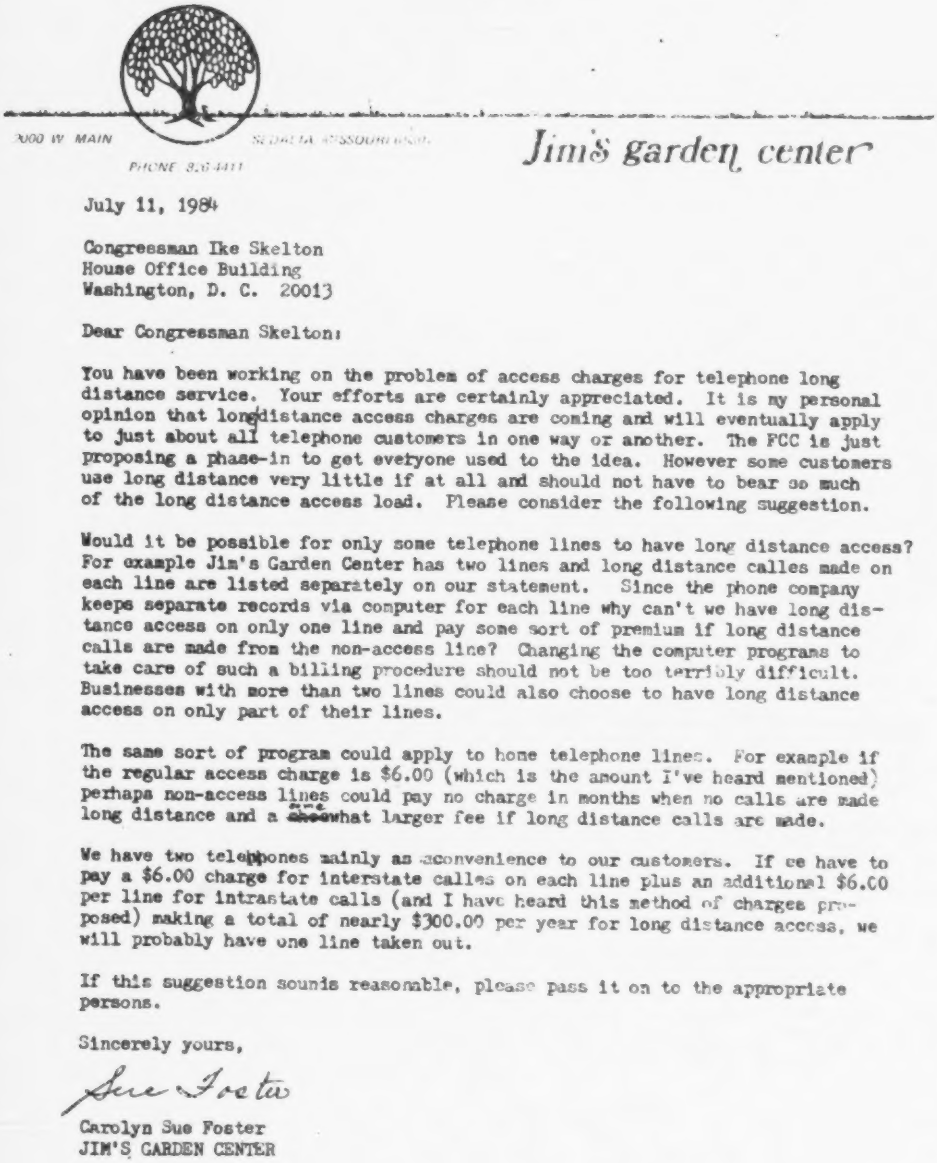
I am in hopes that you and others like yourself, can do something to stop this burden from being laid upon our shoulders, as we have already enough to deal with already. Besides this added burden could quite conceivably be instrumental in the closing of many small businesses.

Thank you for your time, and once again, I do hope that during the course of your investigation, you will find a solution which is more equatabile tham the one offered by the FCC.

Sincerely,

Susan Long
Susan Long

APPENDIX F



2000 W MAIN SEDALIA MISSOURI 65301
PHONE 826-4411
Jim's garden center

July 11, 1984

Congressman Ike Skelton
House Office Building
Washington, D. C. 20013

Dear Congressman Skelton:

You have been working on the problem of access charges for telephone long distance service. Your efforts are certainly appreciated. It is my personal opinion that long distance access charges are coming and will eventually apply to just about all telephone customers in one way or another. The FCC is just proposing a phase-in to get everyone used to the idea. However some customers use long distance very little if at all and should not have to bear so much of the long distance access load. Please consider the following suggestion.

Would it be possible for only some telephone lines to have long distance access? For example Jim's Garden Center has two lines and long distance calles made on each line are listed separately on our statement. Since the phone company keeps separate records via computer for each line why can't we have long distance access on only one line and pay some sort of premium if long distance calls are made from the non-access line? Changing the computer programs to take care of such a billing procedure should not be too terribly difficult. Businesses with more than two lines could also choose to have long distance access on only part of their lines.

The same sort of program could apply to home telephone lines. For example if the regular access charge is $6.00 (which is the amount I've heard mentioned) perhaps non-access lines could pay no charge in months when no calls are made long distance and a somewhat larger fee if long distance calls are made.

We have two telephones mainly as a convenience to our customers. If we have to pay a $6.00 charge for interstate calles on each line plus an additional $6.00 per line for intrastate calls (and I have heard this method of charges proposed) making a total of nearly $300.00 per year for long distance access, we will probably have one line taken out.

If this suggestion sounds reasonable, please pass it on to the appropriate persons.

Sincerely yours,

Sue Foster

Carolyn Sue Foster
JIM'S GARDEN CENTER

APPENDIX G

ROBERT A. PROTZMAN, D.D.S.

August 24, 1984

Congressman Ike Skelton
Telephone Task Force
2361 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressman Skelton:

In responce to your letter for views of the small business telephone access charges, I will attempt to explain my own personal experience with the telephone company (United Telephone). I practice dentistry in Jefferson City, MO and have a phone system consisting of three lines. The first is a courtesy phone in my reception room for the patients use in local calls. The second is an unlisted number connected with Tel-Central for which I use for outgoing calls and long distance. The third is our business phone that is printed in the phone book. At this time, I am being charged an access charge on all three lines.

I have contacted the telephone company on four occasions, each time with a different explanation.

Respectfully,

Robert A. Protzman, DDS.

Robert A. Protzman, D.D.S.

RAP/klb

1304 SOUTHWEST BOULEVARD JEFFERSON CITY, MISSOURI 65101 TELEPHONE 636-5522

APPENDIX H

LAW OFFICES
HAWKINS, BRYDON & SWEARENGEN
PROFESSIONAL CORPORATION
312 EAST CAPITOL AVENUE
P.O. BOX 456
JEFFERSON CITY, MISSOURI 65102-0456

ROBERT L. HAWKINS, JR
DAVID V.G. BRYDON
JAMES C. SWEARENGEN
WILLIAM R. ENGLAND, III
ROBERT L. HAWKINS, III
JOHNNY K. RICHARDSON
STEPHEN G. NEWMAN
MARK W. COMLEY
GARY W. DUFFY
VICKI J. GOLDAMMER

AREA CODE 314
TELEPHONE 635-7166

September 26, 1984

The Honorable Ron Wyden
U. S. House of Representatives
2361 Rayburn House Office Building
Washington, D.C. 20515

Re: Special Task Force on Telephones/Small Business Committee

Dear Mr. Wyden:

Enclosed please find the information from Continental Telephone Company of Missouri in response to requests by members of the Small Business Tax Force at the recent hearing in Kansas City, Missouri.

If you need anything further, please do not hesitate to contact me at your convenience.

Very truly yours,

HAWKINS, BRYDON & SWEARENGEN P. C.

By: Robert L. Hawkins III

Robert L. Hawkins, III

RLH/rlm
cc: Mr. F. M. Harlan

CONTINENTAL TELEPHONE COMPANY OF MISSOURI
Requested Data by the United States Committee
on Small Business - Special Task Force on Telephones

General Data:

1. Provides service to over 20% of the geographic area of Missouri.
2. Areas are generally rural in nature and service is provided via 140 exchanges varying in size from 60 access lines to 6000 access lines.
3. Average exchange size approximates 950 access lines.

Non-Traffic Sensitive Costs:

	Inter-State	Intra-State
1. Present SPF	28.44%	45.71%
Annual Revenues	17.929 M	26.867 M

2. Access lines as of July 1984 - 132,294
3. Assumption:
   a. FCC will reduce present SPF to 0% in the next 3-5 years.
   b. Missouri will receive no contribution from Federal Universal Service Fund.
4. Additional revenue required per access line (business and residential) when SPF is 0%.
   a. Inter-State
   $$\frac{\$17,929,000}{132,294} = \$135.52/\text{yr} = \$11.29/\text{mo}$$
   b. Intra-State
   $$\frac{\$26,867,000}{132,294} = \$203.09/\text{yr} = \$16.92/\text{mo}$$

5. Rate Comparisons (monthly rates)

a. Business

(1)	Present lowest 1-party BRA rate	$12.15
	NTS costs - Inter-State	11.29
	- Intra-State	16.92
	Total	$40.36
	% increase	332.2%
(2)	Percent highest 1-party BRA rate	$16.05
	NTS costs - Inter-State	11.29
	- Intra-State	16.92
	Total	$44.26
	% increase	275.8%

b. Residence

(1)	Present lowest 1-party BRA rate	$ 6.05
	NTS costs - Inter-State	11.29
	- Intra-State	16.92
	Total	$34.26
	% increase	566.3%
(2)	Present highest 1-party BRA rate	$ 8.20
	NTS Costs - Inter-State	11.29
	- Intra-State	16.92
	Total	$36.40
	% increase	443.9%

F. M. Harlan
9-17-84

APPENDIX I

Southwestern Bell
1667 K Street, N. W.
Suite 200
Washington, D.C. 20006
Phone (202) 293-8565

R. Brent Regan
Executive Director-
Federal Relations

September 19, 1984

The Honorable Ron Wyden
Chairman, Task Force on Telephones
Small Business Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Wyden:

I have enclosed the information you requested of our company's witness, Royce Caldwell, during the Task Force hearings in Kansas City, Missouri. Included are:

1. 1982 Exchange Cost Study (Missouri) submitted by Southwestern Bell Telephone Co. in conjunction with Missouri Public Service Commission, Case Number TR-83-253.
2. 1982 Embedded Direct Analysis (Missouri) submitted by Southwestern Bell Telephone Co. in conjunction with the same case.

Both the above relate to your discussion with Mr. Caldwell about how costs of Company operations and services are defined and how those costs are used in state rate setting proceedings. In this context, these may also serve to amplify the discussion between the Mo.P.S.C. Chairman and Members of the Task Force along the lines of how state regulators use cost data.

3. Review of the Nature, Implications, and Risk to Local Telephone Companies of Bypass, by Touche Ross & Co.

You discussed a number of bypass issues with Mr. Caldwell and others on the same panel of witnesses. During that discourse, several references were made to this study, done for Southwestern Bell Telephone Co. One element of its findings was recalled in differing ways. That element concerned consumer motivation for bypassing. Pages 24, 25 and 26 of the study particularly relate to the matter of motivations among the surveyed group of largest telecommunications users in the five-state operating territory of Southwestern Bell Telephone Co. At page 24, for example, "lower cost" is identified as the single most frequently given consideration.

4. Cross Examination Testimony of Dr. Joseph S. Kraemer, Partner, Management Consultant Division of Touche Ross & Company, in the same Mo.P.S.C. case referenced at items 1 and 2, above, and relevant to the study referenced at item 3 above.

The matter of motivation to bypass was also an element of bypass issue inquiry by the Missouri Public Service Commission in its 1983 proceeding. Dr. Kraemer's testimony deals with this element directly, beginning at page 1414 of the transcript here enclosed, referring to price as ". . . the primary motivating factor that we've found across the various jurisdictions in which we've worked."

I hope these additions to the Task Force record prove useful. Please let me know if we may be of further help.

Sincerely,

Brent Ragan

cc: Honorable Ike Skelton

APPENDIX J

Mo. PSC Case No. TR-83-253
Schedule No. 1 (Ewing)
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MISSOURI

EXCHANGE COST STUDY

1982

MISSOURI
EXCHANGE COST STUDY
1982

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MISSOURI
EXCHANGE COST STUDY
1982

OVERVIEW

The Exchange Cost Study (ECS) provides an insight into the revenue/cost relationships among the following classes of exchange service:

1. Residence One Party - Flat
2. Residence Two Party - Flat
3. Residence Four Party - Flat
4. Residence One Party - Measured
5. Residence Two Party - Measured
6. Single Line Business - One Party Flat
7. Single Line Business - Four Party-Flat
8. Single Line Business - One Party Measured
9. Multi-Line Business
10. PBX Trunks
11. Information Terminals
12. Centrex-CU Trunks

For the purpose of this analysis, exchange service is defined as a telephone line terminating in one of our switching central offices, and used for originating and receiving calls only to and from points within the local exchange calling area.

The classes of service are defined as follows:

> Residence includes all residence main and equivalent main telephones, including foreign exchange (FX), auxiliary and service lines and those terminating in customer-provided equipment. This class was further divided into 1 Party, 2 Party, 4 Party - Flat, and 1 Party and 2 Party - Measured.

> Single Line Business includes all Single Line Business (business without line hunting) main and equivalent main telephones including foreign exchange (FX), service lines and those terminating in customer-provided equipment. This

class was further divided into 1 Party, 4 Party - Flat, and 1 Party -Measured. Official, mobile, lines serving TWX, toll telephone, toll terminal and WATS telephones were excluded.

Multi-line Business includes all Multi-line Business (business with line hunting) main and equivalent main telephones, including foreign exchange (FX), auxiliary and service lines, and those terminating in customer-provided equipment. Official, mobile, lines serving TWX, toll telephone, toll terminals and WATS telephones were excluded.

PBX Trunks include all PBX, Business and Residence including inward, outward, 2-way, foreign exchange, and those terminating in customer-provided equipment but excluding official, toll terminals and WATS lines.

CENTREX-CU includes all CENTREX-CU trunks including inward, outward, 2-way, foreign exchange and those terminating in customer-provided equipment but excluding official, toll terminals and WATS lines.

Information Terminal Service is service linking customer-provided data transmitting and/or receiving equipment, excluding official and toll terminals through the Telephone Company central office to the network.

METHODOLOGY

The Exchange Cost Study (ECS) provides a further breakdown of the Embedded Direct Analysis (EDA) Exchange Usage category and the EDA Access Line category.

Access Line - This category, is comprised of the access line investment, drop, cable pair to the central office, and the central office equipment dedicated to the line.

Local Exchange Usage - This category includes the traffic sensitive direct cost generated by Local Exchange Usage. It includes local central office equipment, exchange trunking, local tandem and local operator services.

The Access Line and Local Exchange Usage assignments from the EDA output are the starting points upon which the ECS methodology operates; therefore, the Access Line and Local Exchange Usage assignments to ECS classes balance to the EDA Access Line and Local Exchange Usage results on an item-by-item basis. Since the EDA obtains revenues, investments and expenses from various reports which close to the books of the Company and since the ECS results close to the EDA, the ECS also balances to the Company books.

The costs measured by ECS are direct costs. These are costs which can be identified as being caused directly by the provision of a specific service. EDA Access Line and Local Exchange Usage cost results are assigned to the ECS classes of service.

The Traffic Usage Study results are the basis for assigning traffic sensitive investments and costs. This usage data was obtained in a special traffic usage study in which a sample of customer lines was selected. For each of the sampled lines, usage was recorded during the office busy hour for ten consecutive working days.

CLASS OF SERVICE		# OF CUSTOMERS	TEN-DAY BUSY HOUR HUNDRED CALL SECONDS (BH CCS)	STANDARD DEVIATION
Residence	- 1 party flat	1,179,100	21.3	1.6
	- 2 party flat	42,755	15.2	1.0
	- 4 party flat	31,479	10.6	.9
	- 1 party meas.	4,099	6.5	1.4
	- 2 party meas.	30,635	13.5	2.0
Business	- Multi-line	119,527	52.0	4.9
	- 1 party flat	77,207	42.7	6.6
	- PBX	47,924	99.7	5.4
	- 1 party meas.	32,591	30.9	3.3
	- CTX - CU	1,512	137.1	36.9
	- Info. Term.	718	109.9	29.9
	- 4 party flat	425	14.3	6.6

Revenues have been developed on the basis of the filed tariff charges for each class of exchange service in this analysis. The average monthly revenue per main and/or equivalent main telephone includes weighted average non-recurring service connection charges. Therefore, the revenues shown include both recurring and non-recurring charges.

MISSOURI

EXCHANGE COST STUDY

1982

	TOTAL MONTHLY REVENUE	MONTHLY EXCHANGE USAGE COSTS	MONTHLY ACCESS LINE COSTS	TOTAL MONTHLY COSTS
Residence:				
1-Party Flat	$10.04	$ 6.05	$18.65	$24.70
2-Party Flat	6.11	4.31	14.71	19.02
4-Party Flat	6.86	2.64	13.40	16.04
1-Party Measured	6.53	1.52	19.05	20.57
2-Party Measured	5.19	4.49	14.76	19.25
Business:				
1-Party Flat	25.52	12.18	21.19	33.37
4-Party Flat	10.57	4.19	15.88	20.07
1-Party Measured	23.91	10.50	21.46	31.96
Multi-line	28.42	15.18	21.41	36.59
PBX Trunks	40.73	30.72	23.92	54.64
Information Terminals	46.62	32.28	20.61	52.89
CTX-CU Trunks	51.73	40.75	23.85	64.60

MISSOURI

FULLY ALLOCATED

EXCHANGE COST STUDY

1982

	TOTAL MONTHLY REVENUE	MONTHLY EXCHANGE USAGE COSTS	MONTHLY ACCESS LINE COSTS	TOTAL MONTHLY COSTS
Residence:				
1-Party Flat	$10.04	$ 6.46	$19.66	$26.12
2-Party Flat	6.11	4.60	15.45	20.05
4-Party Flat	6.86	2.79	14.01	16.80
1-Party Measured	6.53	1.61	20.07	21.68
2-Party Measured	5.19	4.80	15.50	20.30
Business:				
1-Party Flat	25.52	12.99	22.20	35.19
4-Party Flat	10.57	4.43	16.47	20.90
1-Party Measured	23.91	11.18	22.48	33.66
Multi-line	28.42	16.20	22.44	38.64
PBX Trunks	40.73	32.78	25.07	57.85
Information Terminals	46.62	34.49	21.62	56.11
CTX-CU Trunks	51.73	43.63	24.99	68.62

Mo. PSC Case No. TR-83-253
Schedule No. 5 (Ewing)
Page 1 of 10

MISSOURI

EMBEDDED DIRECT ANALYSIS

1982

MISSOURI
EMBEDDED DIRECT ANALYSIS
1982

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MISSOURI
EMBEDDED DIRECT ANALYSIS
1982

OVERVIEW

The Embedded Direct Analysis (EDA) is a study of the cost and revenue relationship of several broad categories of service for a prior calendar year. The total of these categories includes all services provided by Southwestern Bell. These categories are:

1. Access Line
2. Exchange
3. State Toll
4. State Private Line
    a. Intraexchange Subvoice
    b. Intraexchange Voice
    c. Interexchange Subvoice
    d. Interexchange Voice
    e. Other
5. Supplemental Services - Residence
6. Supplemental Services - Business
7. Directory and Other
8. Interstate Toll
9. Interstate Private Line
10. Common
11. Terminal Equipment - Residence
12. Terminal Equipment - Simple Business
13. Terminal Equipment - Complex Business
14. Inside Wire - Residence
15. Inside Wire - Simple Business
16. Inside Wire - Complex Business

The costs measured by EDA are direct costs, except for the common cost category. Direct costs are costs which can be identified as being caused directly by the provision of services within a specific category. If the service had not been provided, then these costs would not have been incurred.

Access line costs are a special type of direct cost in that they are the costs associated with providing access into the network. This access to the network may be used either for local exchange service or for state or interstate message telephone service. There is no appropriate cost-causative basis for allocating this access cost to local, state toll or interstate toll service. The level of usage does not affect access cost. Access Line is a separate and distinct service category.

Common costs are not direct costs since they are not directly assignable to the provision of any specific group of products or services. They are corporate overhead costs and as such cannot be assigned on a cost-causative basis.

A fully allocated EDA is included at page 10, and was prepared in response to the Commission's directive in Case No. TR-82-199 that the Company provide "a fully allocated cost study based upon embedded costs". All common costs have been allocated based on net investment to each of the service categories.

EDA assigns booked costs and revenues to the various service categories. This enables the EDA to balance to the books and records of the company. Therefore, for study purposes, a calendar year is chosen since year-end reports are available, year-end accruals are included, and clearing accounts are closed.

SERVICE CATEGORIES DEFINITIONS:

Access Line.....This category represents costs which are common to both Exchange and Toll Services. These are the costs of facilities used to provide access to the telephone network. These costs are non-traffic sensitive, that is, they do not vary with volume of use, or type of use (local telephone service and/or state toll or interstate toll service). They include direct costs for drop wiring on non-coin main telephone service and all station apparatus and wiring on coin services, the loops, and non-traffic sensitive local central equipment. This category also includes certain customer related expenses, such as the preparation and mailing of the customers monthly bill, and the production and distribution of the alphabetical directory. Recurring measured service revenues from services with no usage allowance are assigned to Access Line. Nonrecurring revenues covering the charges for installing basic access to the network are assigned to this category.

Exchange.....This category includes the traffic sensitive direct cost generated by Exchange use. It includes local central office equipment exchange trunking, local tandem and local operator services. All Basic Service Exchange revenues, except those identified above, are assigned to this category.

State Toll.....This category contains the traffic sensitive direct cost generated by state toll use. Also included are the cost of intrastate WATS access lines. All state toll revenues, after settlements, are assigned to this category.

State Private Line.....The direct costs of providing intrastate private line service are included in this category. State private line booked revenues are assigned to this category. Subcategories for intraexchange and interexchange private line service are included.

Supplemental Services - Residence.....The direct costs and revenues of providing additional residence services over and above that required for basic residence exchange service are assigned to this category. The majority of the costs in this category are associated with providing TOUCH-TONE R and Custom Calling Services.

Supplemental Services - Business.....As with the Residence category, the direct costs and revenues of providing additional business services over and above that required for basic business exchange service are assigned to this category. Included are the costs of TOUCH-TONE R and Custom Calling Services and the direct costs and revenues of Centrex CO Intercom Service and Mobile Service among other miscellaneous services.

Directory and Other.....This category primarily consists of the direct cost and revenues for Yellow Pages and leased facilities (such as CATV).

Interstate Toll.....This category contains the traffic sensitive direct cost generated by interstate toll use.. The costs of interstate WATS access lines are also included. The interstate toll revenues booked after settlements are assigned to this category.

Interstate Private Line.....The direct costs of providing interstate private line service are included in this category. Revenues booked to interstate private line are also included in this service category.

Common.....This category includes costs which are common to all categories and which are not directly assignable to specific services on a cost causative basis. Executive, Legal, Financial, and Personnel expenses are included. This category is eliminated in the fully allocated EDA by allocating all common costs to the other service categories.

Terminal Equipment - Residence.....This category includes the direct costs and revenues of all terminal equipment on residence lines and the station handling component of station connections.

Terminal Equipment - Simple Business.....This category includes the direct costs and revenues for all terminal equipment on simple business lines and the station handling component of station connections associated with this terminal equipment.

Terminal Equipment - Complex Business.....This category includes the direct costs and revenues of all terminal equipment associated with complex services. This includes Key, Centrex-CU switching and station, Centrex-CO station, PBX switching and station and all WATS and Private Line station apparatus. It also includes the station handling component of station connections associated with above stations.

Inside Wire - Residence.....This category includes the direct costs and revenues for station connections (excluding station handling) associated with terminal equipment on residence lines.

Inside Wire - Simple Business.....This category includes the direct costs and revenues for station connections (excluding station handling) associated with the terminal equipment on simple business lines.

Inside Wire - Complex Business.....This category includes the direct costs and revenues for station connections (excluding station handling) associated with the terminal equipment on complex business lines. This wiring is also called Intrasystems Premises Wiring.

METHODOLOGY

EDA is an account-by-account analysis of operating revenues, plant investments and all expenses, wages and capital costs for a study area, so that total costs equal total revenues. The advantage of this approach is that the total result "closes to the books", that is, the EDA results are consistent with accounting and financial reports. The revenues associated with each category are first identified and quantified. Then the operating expenses, taxes, and return are assigned to the various service categories on a cost-causative basis. The basis for the cost assignments fall into one of the following groupings:

- Direct Assignments
- Investment Related
- Wage or Other Cost Related
- Work Unit Related
- Special Studies

EDA deals with overall accounts and is not intended to show revenue and costs by individual products or services.

Revenues

The EDA Revenues logic assigns operating revenues to service categories as reported on Monthly Report No. 4. The MR4 divides operating revenues into three broad classifications: Local Service Revenues, Toll Service Revenues and Miscellaneous Revenues. Total Operating Revenues is the sum of these three less Total Uncollectible Operating Revenues. Also, all major operating revenue accounts and sub-accounts are reported on the MR4. Therefore, the sources of revenues for most of the service categories can be readily identified and directly assigned.

Investment

EDA has separate logic for analyzing investments and costs. Many costs (such as taxes, depreciation and return) are assigned on the basis of the related investment. The EDA assigns the fixed assets of the firm to the service categories. This establishes the basis for assigning investment related costs based upon the prior assignment of investments.

The analysis of plant investments begins with the inputting of investment data by account. The methodology then develops investment sub-categories based on the availability of sub-account detail, and the results of the basic studies performed in the Division of Revenue process.

Finally, the sub-categories of investment are assigned to the service categories according to various factors such as usage, lines and telephones, wages, expenses and other related investments.

Expenses

After operating revenues and plant investments have been assigned to the service categories, operating expenses, taxes and return are then assigned on a cost-causative basis. The cost study methodology is as outlined below:

> EDA reduces all cost elements (expenses, taxes, etc.) to the finest detail available from existing company records and reports. This data is included in the EDA input files for each study area.
>
> Each cost item is categorized as a direct cost of one or more services on a cost-causative basis or a common cost.
>
> If the cost item is directly attributable to a single category, then an assignment to the single appropriate service category is made.
>
> If the cost item is directly attributable to several services, a cost related factor is used (e.g., Traffic units, Business Office Work units, circuit miles, etc.) to assign the costs to the appropriate service categories.

MISSOURI

EMBEDDED DIRECT ANALYSIS

1982

($000,000)

	REVENUES	COSTS	CONTRIBUTION
ACCESS LINE	19.05	377.63	-358.58
EXCHANGE USE	267.97	184.63	83.34
STATE TOLL USE	174.20	84.88	89.31
STATE PRIVATE LINE			
Intraexchange Subvoice	5.08	8.55	-3.47
Intraexchange Voice	16.39	28.35	-11.96
Interexchange Subvoice	0.70	0.66	0.04
Interexchange Voice	11.20	11.99	-0.79
Other	0.92	0.83	0.09
Subtotal	34.29	50.38	-16.09
SUPPLEMENTAL SERVICES-RESIDENCE	34.20	2.80	31.40
SUPPLEMENTAL SERVICES-BUSINESS	27.29	18.26	9.03
DIRECTORY AND OTHER	78.92	27.38	51.54
COMMON TO FIRM	0.00	57.24	-57.24
INTERSTATE TOLL USE	303.17	114.14	189.03
INTERSTATE PRIVATE LINE	53.48	39.56	13.92
TERMINAL EQUIPMENT-RESIDENCE	78.89	58.57	20.31
TERMINAL EQUIPMENT-SIMPLE BUSINESS	4.27	5.02	-0.75
TERMINAL EQUIPMENT-COMPLEX BUSINESS	141.50	146.33	-4.83
INSIDE WIRE-RESIDENCE	0.96	20.73	-19.77
INSIDE WIRE-SIMPLE BUSINESS	0.96	3.16	-2.20
INSIDE WIRE-COMPLEX BUSINESS	9.59	38.01	-28.42
TOTAL FIRM	1228.74	1228.74	0.00

MISSOURI
EMBEDDED DIRECT ANALYSIS
1982
($000,000)

	REVENUES	COSTS	CONTRIBUTION
ACCESS LINE	14.20	377.39	-363.19
EXCHANGE USE	267.97	184.63	83.34
STATE TOLL USE	174.20	84.88	89.31
STATE PRIVATE LINE			
Intraexchange Subvoice	5.08	8.55	-3.47
Intraexchange Voice	16.39	28.35	-11.96
Interexchange Subvoice	0.70	0.66	0.04
Interexchange Voice	11.20	11.99	-0.79
Other	0.92	0.83	0.09
Subtotal	34.29	50.38	-16.09
SUPPLEMENTAL SERVICES-RESIDENCE	34.20	2.80	31.40
SUPPLEMENTAL SERVICES-BUSINESS	27.28	18.26	9.02
DIRECTORY AND OTHER	78.92	27.38	51.54
COMMON TO FIRM	0.00	57.24	-57.24
INTERSTATE TOLL USE	303.17	114.15	189.02
INTERSTATE PRIVATE LINE	53.48	39.56	13.92
TERMINAL EQUIPMENT-RESIDENCE	78.89	58.57	20.31
TERMINAL EQUIPMENT-SIMPLE BUSINESS	4.27	5.02	-0.75
TERMINAL EQUIPMENT-COMPLEX BUSINESS	146.36	146.56	-0.20
INSIDE WIRE-RESIDENCE	0.96	20.73	-19.77
INSIDE WIRE-SIMPLE BUSINESS	0.96	3.16	-2.20
INSIDE WIRE-COMPLEX BUSINESS	9.59	38.01	-28.42
TOTAL FIRM	1228.74	1228.74	0.00

MISSOURI
FULLY ALLOCATED
EMBEDDED DIRECT ANALYSIS
1982
($000,000)

	REVENUES	COSTS	CONTRIBUTION
ACCESS LINE	19.05	397.20	-378.15
EXCHANGE USE	267.97	195.45	72.52
STATE TOLL USE	174.20	89.08	85.12
STATE PRIVATE LINE			
Intraexchange Subvoice	5.08	9.00	-3.92
Intraexchange Voice	16.39	30.00	-13.61
Interexchange Subvoice	0.70	0.70	0.00
Interexchange Voice	11.20	12.84	-1.64
Other	0.92	0.88	0.04
Subtotal	34.29	53.42	-19.13
SUPPLEMENTAL SERVICES-RESIDENCE	34.20	2.88	31.32
SUPPLEMENTAL SERVICES-BUSINESS	27.29	19.19	8.10
DIRECTORY AND OTHER	78.92	27.56	51.36
COMMON TO FIRM	0.00	0.00	0.00
INTERSTATE TOLL USE	303.17	120.81	182.37
INTERSTATE PRIVATE LINE	53.48	42.24	11.25
TERMINAL EQUIPMENT-RESIDENCE	78.89	60.23	18.65
TERMINAL EQUIPMENT-SIMPLE BUSINESS	4.27	5.15	-0.88
TERMINAL EQUIPMENT-COMPLEX BUSINESS	141.50	150.75	-9.25
INSIDE WIRE-RESIDENCE	0.96	21.82	-20.86
INSIDE WIRE-SIMPLE BUSINESS	0.96	3.30	-2.34
INSIDE WIRE-COMPLEX BUSINESS	9.59	39.67	-30.08
TOTAL FIRM	1228.74	1228.74	0.00

MISSOURI
FULLY ALLOCATED
EMBEDDED DIRECT ANALYSIS
1982
($000,000)

	REVENUES	COSTS	CONTRIBUTION
ACCESS LINE	14.20	396.96	-382.76
EXCHANGE USE	267.97	195.45	72.52
STATE TOLL USE	174.20	89.08	85.12
STATE PRIVATE LINE			
Intraexchange Subvoice	5.08	9.00	-3.92
Intraexchange Voice	16.39	30.00	-13.61
Interexchange Subvoice	0.70	0.70	0.00
Interexchange Voice	11.20	12.84	-1.64
Other	0.92	0.88	0.04
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TERMINAL EQUIPMENT-SIMPLE BUSINESS	4.27	5.15	-0.88
TERMINAL EQUIPMENT-COMPLEX BUSINESS	146.36	150.98	-4.62
INSIDE WIRE-RESIDENCE	0.96	21.82	-20.86
INSIDE WIRE-SIMPLE BUSINESS	0.96	3.30	-2.34
INSIDE WIRE-COMPLEX BUSINESS	9.59	39.67	-30.08
TOTAL FIRM	1228.74	1228.74	0.00